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ABSTRACT

As part of a 5-year evaluation of the William D. Ford Federal Direct Loan Program, this study assessed the U.S. Department of Education's (ED) administration of the program. Data were obtained through interviews with ED and other federal officials, institutional surveys, reviews of documents, attendance at meetings and training events, facilitated groupware sessions, and institutional case studies. Major findings indicated that: (1) program participation plateaued after rapid growth the first 3 years; (2) the loan origination transition process experienced multiple difficulties and delays; (3) a high level of customer service was provided during the first three years of this program to institutions by ED and its contractors; (4) direct loan training and program materials were enhanced; (5) multiple loan servicing contracts were canceled; and (6) staffing and resource shortages exist in key areas. After a summary of highlights and an introduction, the evaluation's findings are detailed for specific processes and services of the program, including loan origination, reconciliation, loan servicing, consolidation, debt collection, support services, and training and resource materials, ED management findings, specifically financial, contract, and organizational management are also discussed. (DB)

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ED 416 769

U.S. Department of Education
Office of the Under Secretary

Direct Loan Evaluation Assessment of Department of Education Administration: Academic Year 1995-96 and 1996-97

Summary Report

1998

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Direct Loan Evaluation
Assessment of Department of Education Administration: Academic Years 1995-96 and 1996-97

Volume One—Summary Report

Contract No. EA93085001

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1998

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Summary of Highlights

Summary of Highlights

Macro International Inc. (Macro) and Coopers & Lybrand L.L.P. are conducting an assessment of the U.S. Department of Education's (ED) administration of the William D. Ford Federal Direct Loan Program (Direct Loan Program). This is part of a large evaluation commissioned by ED to examine the overall effectiveness of the Direct Loan Program in providing simplified administration and customer satisfaction. Other evaluation components include institutional and borrower surveys and institutional case studies.

This assessment summarizes the key findings and issues critical to ED's operation of the Direct Loan Program for the 1995-96 and 1996-97 academic years (Years 2 and 3 of Direct Loan Program operation). Information for this report was obtained through interviews with ED and other Federal officials, institutional surveys, review of pertinent documents, attendance at meetings and training events, facilitated groupware sessions, and institutional case studies.

The second and third years of the Direct Loan Program (academic years 1995-96 and 1996-97) brought a myriad of challenges resulting from increases in institutional participation and a concomitant increase in loan volume. Direct Lending now accounts for approximately one third of the total Federal loan volume. The total cumulative volume of Direct Loans rose from $1.6 billion in the first year to an estimated $18 billion today, with approximately 2.3 million borrowers.

The findings discussed here represent the 1995-96 and 1996-97 Direct Loan experience, including the effects of the increase in institutional participation and loan volume, from both the customers' and the Department's perspective. The following findings represent the major highlights and issues that occurred within these timeframes.

Findings

- **Direct Loan Participation Plateaued**

  Overall participation levels plateaued after 1995-96 (Year 2 of the program). Approximately 70 new schools signed up for Year 4 of the program (1997-98). This low level of new participation may indicate that schools have reservations about the viability of the program. Possible reasons for having reservations about the program include the lengthy battles in Congress over the program and the contracting problems that affected loan origination and consolidation in 1996-97. The low participation level may also reflect improvements by Federal Family Education Loan (FFEL) Program lenders designed to make the FFEL Program more appealing to schools.

- **Loan Origination Transition Experienced Multiple Difficulties and Delays**

  Through February 1997, customer satisfaction with the former Loan Origination Center (LOC) continued to be high (consistent with Year 2 findings). The loan origination process ran smoothly as schools gained experience in administering Direct Loans.

However, all major facets of loan origination—including loan origination, reconciliation, and consolidation—experienced difficulties as the Department transitioned from one LOC to another. ED completed the transition of the Direct Loan origination system to the new LOC—EDS in Montgomery, Alabama—in early March 1997. There were problems with the transfer of data from the former LOC (CDSI/AFSA) to EDS, which resulted in lengthy delays in processing. In addition, customer service problems at EDS occurred because of a lack of staff training in the principles of customer service, a lack of experience in the Direct Loan program, and a lack of responsiveness in following up with customers.

There were also dramatic differences in the way the reconciliation process operated during the first part of the 1996-97 academic year under the former LOC and during the latter part of the academic year under the current LOC. Between March 1997 and May 1997, issues that contributed to delays in the reconciliation process at the institutional level included conversion problems and an inability to produce management information systems (MIS) reports for schools.

Prior to the LOC conversion, ED records indicated that the majority of Direct Lending schools were up to date in processing monthly reconciliation. Reasons stated for the improvement in the process included elimination of software bugs in ED's processing software, more comprehensive training, and changes in the definition of the process by ED. In addition, in March 1996, the Direct Loan Task Force formed the Accountability and Reconciliation Team (ART) to address reconciliation issues at the institutional level.

The loan consolidation process also experienced numerous problems, resulting in the decision by ED in August 1997 to stop accepting new loan consolidation applications. The reasons given for the indefinite shutdown were to clear the backlog of applications and to achieve better financial management of the process. Although the current consolidation process was designed to be largely automated (e.g., automation of edits), ED officials noted that several aspects of the consolidation process were both structurally flawed and required manual processing.

- **A Continued High Level of Customer Service Was Provided to Institutions by ED and Its Contractors**

One of the most important aspects of loan delivery was the high level of customer service and technical support provided by ED and its contractors during the first 3 years of Direct Loan administration. Customer service efforts included a number of new initiatives in 1995-96 and 1996-97, such as the Regional Office Client Account Managers (CAMs) and the ED electronic bulletin board system and World-Wide Web site. Case study schools' Financial Aid Officers (FAOs) gave generally positive feedback regarding ED's level of customer service. They specifically noted favorable interactions with their CAMs.

- **Direct Loan Training and Program Materials Were Enhanced**

  With the startup of permanent training facilities at the Regional Offices, ED transformed its approach to training. In general, case study schools found ED-sponsored training to be useful and cost effective. Case study institutions cited the availability of training and expansion of training offerings at Regional Offices as improvements over previous years. Additional improvements included the provision of levels of training from beginner to advanced, more topics, and the ability of financial aid officers to receive on-site program training by CAMs at their institutions.

- **Multiple Loan Servicing Contracts Were Canceled**

  Since the program's inception, Direct Loans have been serviced by a sole contractor. Contracts for three additional servicers were awarded in September 1996 to accommodate a projected increase in loan volume. After beginning the implementation process for the three additional servicers, ED announced in October 1997 that it would remain with one servicer. The stated reasons for this decision were lower servicing volume than expected, anticipated costs, and more efficient oversight and contract management. ED spent upwards of $40 million on the multiple servicer contracts prior to making the decision to cancel them.

- **Staffing and Resource Shortages Exist in Key Areas**

  There was a perception among ED officials that inadequate staff or resources exist in key organizational units. Areas affected include contracts, systems, loan origination, and loan servicing. There was some concern internally that the Department did not have the right people with the right training doing the right things. Having adequate staff with technical and contracting expertise is especially critical for ED.

Chapter I

Introduction

Chapter I. Introduction

Macro International Inc. (Macro) and Coopers & Lybrand L.L.P. are conducting an assessment of Department of Education (ED) Administration as part of the evaluation of the William D. Ford Federal Direct Loan Program (Direct Loan Program). Commissioned by the U.S. Department of Education, this evaluation examines the overall effectiveness of the Direct Loan Program in terms of simplified administration, and customer satisfaction. Other evaluation components include institutional and borrower surveys, and institutional case studies.

The objectives of the ED Assessment are to

1. Assess to what extent the Department has efficiently and effectively managed the Direct Loan Program and delivered high-quality service to its customers

2. Assess to what the extent the Department has organized and streamlined its administrative processes and method of service delivery to most effectively manage the Direct Loan Program, currently and in subsequent years.

This assessment summarizes the outcomes of ED's operation of the Direct Loan Program for the 1995-96 and 1996-97 academic years (Years 2 and 3 of Direct Loan Program operation).

Background

Since 1965, Federal student loans have been awarded under what is currently referred to as the Federal Family Education Loan (FFEL) Program. Under this program, private lenders provide loan principal for Federal Stafford Loans (student borrowers) and Federal PLUS Loans (parent borrowers). Loans are guaranteed by the Federal Government through State and nonprofit guaranty agencies. The school certifies a student's eligibility for a loan, and then the guaranty agency and the lender approve the loan. The lender then sends the loan amount to the school, which disburses the proceeds to the student or parent (in the case of a PLUS loan).

In 1993, through the Omnibus Budget Reconciliation Act, the Federal Government created a new loan program, the William D. Ford Federal Direct Loan (Direct Loan) Program. The Direct Loan Program differs from the FFEL Program in that the Federal Government provides the loan principal for both student and parent loans; private lenders are not involved. Under Direct Lending, the school certifies a student's (or parent's) eligibility for the loan, and the Department of Education then sends the loan amount to the school, which disburses the proceeds to the student or parent (in the case of a PLUS loan).

The Direct Loan Program has been operating since the 1994-95 academic year. As of the 1996-97 year, Direct Lending accounted for approximately one third of total loan volume, with FFEL accounting for the remaining two thirds. The Direct Loan Program differs from FFEL in the following important aspects:

- The source of capital for Direct Loans is Federal borrowing on long-term Treasury notes, compared to privately provided capital through more than 8,000 lenders in FFEL.

- Direct Loans does not utilize guaranty agencies as intermediaries, as does FFEL; thus, there are no administrative allowance payments to these agencies and no reinsurance payments on defaulted loans.

- Under Direct Loans, borrowers' loan applications are processed by postsecondary educational institutions and companies hired under contract by ED; in FFEL, borrowers apply to a lender. A financial aid package is prepared by the institution, and the loan is guaranteed by a guaranty agency.

- The Department, through Direct Lending, offers borrowers flexible repayment options, including graduated or extended repayment schedules, or income-contingent repayment. The Higher Education Act also encourages, but does not require, lenders to offer such flexible options to their student loan borrowers.

Methodology

Direct Lending is a dynamic program in that changes and improvements are constantly being instituted to make the program better. With a focus on ongoing processes, there is no single point in time at which to assess "success," nor are there a few key outcome measures whose results can be used to judge ED's management of the Direct Loan Program as a whole. The findings presented in this report summarize the outcomes of administration of the Direct Loan Program in 1995-96 and 1996-97. Therefore, follow-up on certain dynamic issues has been purposely limited. Instead, the use of data is intended to provide an empirical base of evidence for ED program managers and policy makers to use for improving the program. No single source of data could possibly provide the needed insights into the operations of this complex program. For this reason, we used a combination of data collection methods to examine different aspects of program development and to derive study findings.

Whenever possible, data from each source were cross-validated with data from other sources before conclusions were drawn. Separate interviews with the various persons involved in each program component were used to compare perceptions of processes occurring within both ED and its contractors. Wherever feasible, Macro staff questioned opinions obtained in interviews by seeking data to support these opinions in the form of MIS reports, contractors' statements of work and work production invoices, program performance measures, internal business plans such as ED's reintegration plan, and program outcome data with measures such as volume, frequencies, time. Disparate data were analyzed and synthesized to produce this report.

Although great care was taken to triangulate findings wherever possible, some of the information presented in this report is, by definition, anecdotal. In these situations, we were careful not to base

inferences on this information alone; findings from the other parts of Macro's evaluation were used to buttress this information before any conclusions or recommendations were made.

Several sources of information were used to address evaluation objectives, including an advisory-workgroup meeting, interviews with ED staff and officials, facilitated group sessions, document review, attendance at meetings and training events, and institutional case studies. Each of these sources is described below.

Interviews With ED Staff and Officials

More than 40 interviews per year were conducted with staff and officials from ED and other Government agencies who had responsibilities under Direct Lending in 1995-96 and 1996-97. The purposes of the interviews were to document and describe the Direct Loan Program and the Family Federal Education Loan Program (FFELP). The interviews began with high-level officials to ascertain policy goals and the management actions taken to achieve them. Interviews were then conducted with staff in charge of ED operations and service delivery of the program.

Two project team members conducted each interview, using a standard protocol on program implementation, regarding the following: policy and operational goals, Direct Loan activities to date, progress in program implementation, and streamlining of ED administrative functions.

Because many officials had been interviewed previously, substantial followup questioning took place. Interview protocols were further tailored to each participant on the basis of the individual's area of operation. In order to maintain their confidentiality, respondents are not identified.

Macro also solicited input from staff at five Regional Offices. These visits were designed to document customer support initiatives, describe primary activities, and assess communication between Regional Office staff and ED officials.

Facilitated Group Sessions

Facilitated group interview sessions were used for the first time in 1996-97. GroupSystems software was used to facilitate the sessions. GroupSystems is a tool that electronically solicits and organizes responses to specific questions, allowing participants to anonymously input their perspectives. It has been used successfully in many Government agencies for brainstorming, gathering opinions, and reaching consensus on a variety of topic areas. Participants in the facilitated sessions included ED staff from program areas that administer or interact with Direct Lending, including the Direct Loan Task Force, Institutional Participation and Oversight Service, Policy Training and Analysis Service (PTAS), Program Systems Service

(PSS), AFMS, Contracting, and Budget Services, and the Direct Loan Client Account Management Group.

The participants in the structured sessions were asked to provide their perspectives on Program Year 3 successes, issues, and ideas for improvement. The perspectives were discussed as a group to bring out both the absolute and the relative importance of the various Direct Loan issues. These discussions also clarified and consolidated major themes. The group dynamic created an environment in which issues could be discussed from several perspectives at the same time (e.g., systems, financial, policy, contracts), which added value not only for this evaluation but for the participants as well. Project staff used the output from the sessions, together with other data, to assess ED performance.

Results of Annual Survey of Direct Loan and FFELP Institutions: Academic Year 1996-97

This third annual customer satisfaction survey was administered to institutions participating in the Federal Direct Loan and Federal Family Education Loan Programs. Approximately 2,200 institutions completed surveys between May and August of 1997. This depicts nationally representative samples of FFEL schools and schools that began participating in Direct Lending in the second year of the program.

Feedback From Institutional Case Studies

Macro conducted 19 site visits to institutions during the 1995-96 academic year and 14 site visits during the late winter and early spring of 1997. The purpose of the case study visits was to gather detailed information about the schools' experiences with the Direct Loan Program. Of the 14 schools that were visited in 1997, 10 of the case study institutions first originated Direct Loans during the third year of the program—academic year 1996-97. Two additional schools originated Direct Loans for 1 year, 1995-96, and then reverted to the FFEL Program. The institutions included proprietary schools, 4-year publics, 4-year privates, and 2-year publics.

A summary report was prepared each year to assess schools' satisfaction with the timeliness and quality of the services and support provided by ED and its contractors and to describe schools' implementation processes for Direct Lending. Issues examined included whether the Direct Loan Program was simpler or more complex to administer than the FFEL Program, problems that schools experienced in administering Direct Loans, and best practices at institutions.

The findings provide insight into the experiences of institutions participating in the Direct Loan Program. Information gathered during case study visits identified issues of concern to schools so that we could examine what ED was doing to respond to their customers.

Document Review

Building on the effort begun during the first 3 years of the study, information on the program continues to be gathered and reviewed by Macro and placed in the project library. Sources range from newspaper and journal articles to bulletins and memos produced by ED and the higher education community. Collection, content review, and compilation of all documents produced for the Direct Loan Program provide essential information about the formal, intended aspects of the program to compare with the more informal perceptions of managers and other participants that are related in interviews. The document review also serves to validate the information, issues, perspectives, and opinions accumulated through interviews.

Observation at Training and Conferences

Observation at training and conferences is a way for project staff to obtain current information on Direct Loan activities and to collect firsthand observations from the financial aid community, ED officials, and industry experts. Project staff attended institutional conferences, Direct Loan training workshops, and Title IV training workshops.

Advisory Workgroup

Macro has convened advisory-workgroup meetings on an annual basis since project inception. Advisory-workgroup members consist of institutional staff representing both the Family Federal Education Loan (FFEL) Program and the Direct Lending Program. Workgroup tasks include review of Macro's analysis plans and provision of inputs for project components, as well as review of project reports for content and accuracy. Workgroup members reviewed interview protocols, reviewed report organization, and contributed program material for this report. In addition, Macro communicates with workgroup members throughout the year in order to gather timely opinions and remain current on program developments.

This Report

This remainder of this report comprises the following chapters:

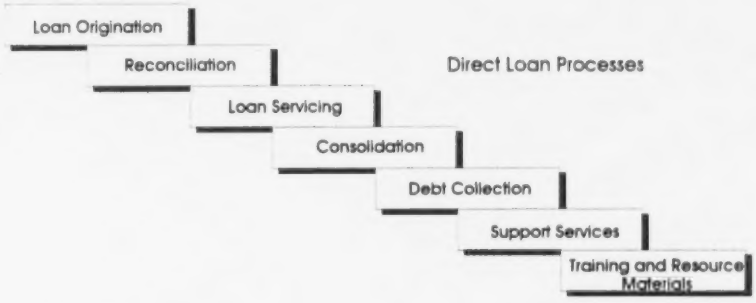
Chapter II. Processes and Services—Assesses Direct Loan processes and services, including origination, reconciliation, servicing, consolidation, debt collection, support service, and training and resource material. Issues, new initiatives, progress, and recommendations are discussed for processes and services in this chapter.

Chapter III. ED Management—Discusses financial management, contract management, and organizational management among various Department entities.

Chapter II

Processes and Services

Process Overview



This chapter is organized around the loan delivery processes and services that comprise the administration of Direct Lending. The order of this section reflects the life cycle of a Direct Loan. The processes and services loan origination, reconciliation, loan servicing, consolidation, debt collection, support service, and training and resource materials are assessed primarily from the perspective of the Department of Education (ED). Institutional, and to a lesser extent, borrowers', perspectives are also included. While conducting this assessment, Macro focused on current activity, changes, and new initiatives during the 1995-96 and 1996-97 academic years. Table II-1 provides a brief overview of Direct Loan processes and services.

Table II-1

Description of Direct Loan Processes and Services

Process or Service	Participants	Functional Description
Loan Origination	ED, Borrower, Institution	Encompasses all "front-end" delivery processes, including application process (and promissory note procedure), origination, acknowledgment processes, funds drawdown, and disbursement.
Reconciliation	ED, Institution	Process by which school-based loan disbursement data are "balanced" against originated loan amounts contained in the promissory note and disbursed by the school. Schools reconcile two types of records: cash records and loan detail records.
Loan Servicing	ED, Borrower	Refers to the processes that occur during loan repayment. Activities include repayment under four repayment plans, deferment, and forbearance processing.
Consolidation	ED, Borrower	The process by which a borrower in repayment consolidates multiple loans into a single loan with a single monthly payment. Both FFELP and Direct Loans and several other educational loans may be consolidated into a single Direct Consolidation Loan.

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Table II-1(Continued)

Description of Direct Loan Processes and Services

Process or Service	Participants	Functional Description
Debt Collection	ED, Borrower, Institution	The process by which ED seeks loan repayment from borrowers who are in default.
Support Services	ED, Borrower, Institution	Various customer service entities are provided by ED to Direct Lending schools, including the Direct Loan Task Force, Regional Office Client Account Managers, and software and loan origination contractors.
Training and Resource Materials	ED, Borrower, Institution	A range of support services supplied by ED and its contractors that are designed to provide training, written materials, software, and technical references to Direct Lending schools.

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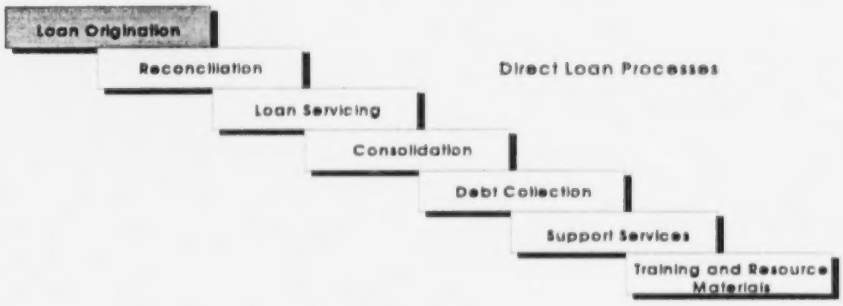
Loan Origination



The Loan Origination Center (LOC) is the contractor responsible for Direct Lending activities up to repayment. The functions that make up the origination process include promissory note and loan origination processing, estimation and drawdown, disbursement, and loan changes. In addition to those functions, the LOC is responsible for fielding all school and borrower inquiries regarding the status of Direct Loans.

The former loan origination contractor, AFSA Corporation of Utica, NY, under subcontract to Computer Data Systems, Inc. (CDSI), had operated in that capacity since program inception and also performed all Direct Loan servicing. The Department, in order to separate Direct Loan functions and take advantage of the competitive bid process, issued a Request for Proposal (RFP) for a new LOC as well as for additional servicers. The new LOC was awarded to a single contractor, EDS Corporation of Montgomery, Alabama, in late Fiscal Year 1995. The award called for EDS to have a new system in place for program year 3 beginning in July 1996. EDS was unable to implement its system by the specified date, so ED had to continue to use CDSI/AFSA until EDS was ready. After lengthy delays, loan origination operations were transferred from CDSI/AFSA to Electronic Data Systems (EDS) on March 3, 1997. (Prior to the change of loan origination contract, CDSI/AFSA had been responsible for all loan origination activities as well as loan servicing. Now, they are only responsible for servicing loans, i.e., all loan activities occurring after a loan has been disbursed and reconciled.) Loan origination experienced many difficulties in 1997, beginning in March, as the Department transitioned from one contractor to another. The following sections highlight issues experienced during the transition.

Table II-2 shows both Direct Loan originations and loan volume by year and total to date.

Macro's data collection and research revealed distinct differences of opinion about the operations of the former and current LOCs. Accordingly, opinions regarding both LOCs are offered separately in this section and in the following sections on reconciliation and customer service.

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Table II-2

Total Direct Loan Originations and Loan Volume by Program Year

	1994-95 Program Year 1		1995-96 Program Year 2		1996-97 Program Year 3		1997-98 Program Year 4*		Program-to-Date	
	Originations	Dollar Amount ($)	Originations	Dollar Amount ($)	Originations	Dollar Amount ($)	Originations	Dollar Amount ($)	Originations	Dollar Amount ($)
Subsidized Stafford	320,179	1,146,276,483	1,594,915	5,393,742,155	1,800,217	6,100,491,098	571,322	2,206,679,471	4,286,633	14,847,189,207
Unsubsidized Stafford	148,392	517,650,981	831,091	2,765,632,138	1,024,721	3,446,466,536	310,909	1,258,864,079	2,315,113	7,988,613,734
PLUS	36,103	198,683,607	174,510	930,395,353	206,771	1,154,432,356	62,949	429,800,623	480,333	2,713,311,939
Total	504,674	1,862,611,071	2,600,516	9,089,769,646	3,031,709	10,701,389,990	945,180	3,895,344,173	7,082,079	$25,549,114,880

* As of week ending August 1, 1997.

Source: U.S. Department of Education MIS Reports.

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Overall, case study Financial Aid Officers (FAOs) reported being very satisfied with the Direct Loan origination process. They said that once they became familiar with the system, it proceeded smoothly and efficiently. Most FAOs said the level of effort equaled that of processing FFEL loan applications but consisted of different activities, such as printing promissory notes and reconciling loans. Schools with multiple lenders under FFEL reported that Direct Lending required less effort because the fact that all loans are from a single source eliminates the difficulties caused by variations in lenders' application forms.

Institutions Expressed Satisfaction With the Former Loan Origination Contractor

In general, case study schools were satisfied with their interactions with CDSI/AFSA. That satisfaction was supported by the fact that most schools were successfully performing all facets of the loan origination process. Case study schools and ED officials indicated that in comparison to the first year of Direct Lending, Year 2 and Year 3 schools were finding few origination records rejected, better software edits, and few problems with the promissory note and loan disbursement procedures.

Case study schools particularly appreciated CDSI/AFSA's level of customer service and the firm's assistance in walking schools through the loan tasks. They reported receiving better service from this LOC than from their FFEL servicers. The majority of FAOs at the case study schools highly praised CDSI/AFSA's technical support staff for their friendly and supportive attitude in helping schools resolve origination problems. The schools reported that if the problems were relatively simple, they received answers quickly. However, the more difficult or complex the problem, the less likely it was that support staff were able to resolve it without the assistance of other staff. The FAOs did note that the technical support staff almost always called back with an answer.

The Current Loan Origination Contractor Experienced Startup Difficulties

From an institutional perspective, the most significant problems occurring during the LOC conversion were lengthy processing delays and numerous data conversion problems. One Regional Office staff member said there was a "laundry list" of issues related to the conversion. Some of those issues included

- Duplicate disbursement rosters;
- No electronic promissory note manifests;
- Error code and reject code problems for origination records, promissory notes, disbursement records, and loan changes;

- Lack of management information system (MIS) reports; and
- No reconciliation files.

More serious problems from a program integrity standpoint included

- Schools not receiving Direct Loan funds;
- Schools receiving duplicate funds;
- Schools receiving funds for ineligible borrowers; and
- Schools drawing down funds without submitting loan origination records.

ED officials noted that the most important lesson they learned was how much the schools rely on the electronic promissory note acknowledgment report. Schools use this roster to compare against their manifests of promissory notes sent to the LOC. This report is the only confirmation schools have that promissory notes were accepted by the LOC. Many schools do not disburse loan funds until they receive the roster. The Department was unaware of the significance of acknowledgment reports to schools prior to the conversion, but discovered schools' reliance on them during EDS's attempts to produce them.

In some cases, those problems were not resolved until late spring 1997—which is the end of the processing year for most nonproprietary schools. The transition to and operations of program Year 4 will be especially important, given that one of ED's goals for the Direct Loan Program, especially during peak processing periods, is to maintain a high level of school satisfaction.

ED Experienced Difficulties Transitioning to the Current Loan Origination Contractor

Through the competitive contracting process, Electronic Data Systems, Inc. (EDS), was chosen as the new loan originator, with a target date to begin loan originations by January 15, 1996. The target date, however, was not met, for a number of reasons (discussed below), and the Department responded by placing a contingency plan in place that involved extending the current contract with CDSI to perform loan originations for Year 3.

The Department also worked with EDS to develop a new implementation plan whereby loan originations could begin by March 1, 1997, for the beginning of Year 4 operations. This implementation date was chosen because application volumes are relatively low and, therefore, would be the best time to begin the transition to the EDS system. In addition, the new Year 4 software would be ready by then and could also coincide with the transition to EDS.

As the Department worked with the contractor to effect the new implementation plan, a number of system design and management problems were experienced that led to making adjustments, including the replacement of the original contractor management team. An ED official indicated that the contractor's problems were due to a number of reasons, including

1. lack of staff with sufficient financial aid experience—a "functional disconnect";

2. underestimation of the complexity of the loan origination process from a systems standpoint; and

3. emphasis on data processing systems over customer service systems: the Direct Loan origination system needed to be the reverse—a customer service system backed up by a data processing system.

ED completed the transition of the Direct Loan origination system to the new LOC in early March 1997. Regarding the transition, the Assistant Secretary noted that

> *The transition to new contractors has not been problem free. With respect to the new loan origination contractor (Electronic Data Systems, or EDS), we experienced some unfortunate but temporary degradation of service to the Direct Loan community. We knew there would inevitably be some disruption in the transition . . . We worked very hard to make a seamless transition. However, both the Department and our contractor did not live up to our expectations regarding computer systems activity and general customer service.*[1]

A main problem with the loan origination system/transition was the data conversion from CDSI/AFSA to EDS. EDS had to convert five million student loan records, and there were major problems with this conversion—EDS's system is more rigorous in enforcing data standardization than CDSI's. Although EDS was required to test the new loan origination system, and according to one ED official, did so satisfactorily, the large number of nonstandard data points was not anticipated by either ED or EDS. Another ED representative noted that "EDS failed to anticipate the level of problems that it encountered, and the Department and CDSI must share some of the blame." Furthermore, schools' satisfaction with the Direct Loan Program was jeopardized by unsatisfactory customer service. Other problems encountered related to the processing of electronic manifests, promissory-note acknowledgments, and batch integrity. Due to general delays including the acknowledgment of promissory notes, ED extended the deadline for submitting 1995-96 academic year electronic loan records and promissory notes from July 31 to October 31, 1996.

Both ED and EDS staff worked diligently to address transition issues. During the transition period, ED sent out multiple communications to Direct Loan stakeholders to address relevant

[1] Longanecker, David, *Statement on Student Financial Aid Delivery Systems before the Committee on Labor and Human Resources*, United States Senate (May 15, 1997).

questions, concerns, and issues. EDS expanded production shifts in mid-April, and ED staff regularly traveled to Montgomery to help identify and resolve recurring problems.

As of May 1997, five million records had been transferred from the former LOC to the current LOC; 226,000 promissory notes had been acknowledged; and 897,000 loan disbursements totaling nearly $1 billion had been made.[2] According to one ED official, the contractor is now meeting most of its contractual performance measures (e.g., turnarounds, response-time requirements, answering the telephones), although that was not the case in the March-May timeframe. ED staff have reported that there have been no problems with the system thus far for processing 1997-98 loan originations (other than loan consolidation), and that they are ready to handle peak processing. The Department and EDS are now working towards batch time reductions and run-time improvements, and are implementing new generations of hardware that will increase processing speed and handle even greater amounts of data.

Through February of 1997, EDS was paid a flat monthly fee for loan origination and consolidation efforts regardless of volume, because pricing schedules were not renegotiated to reflect changes that arose from contract delays. The Department plans to renegotiate the fees for deliverables in the near future, allowing the Department to recapture some of the excess costs being paid for lower-than-anticipated levels of origination and consolidation activity while EDS was experiencing startup delays.

Contracting Practices, Poor Planning Contributed to Loan Origination Difficulties

ED officials cited several contracting practices that contributed to the difficulties by EDS in getting the loan origination system up, including

- Lack of collaboration with ED users and other program areas, such as Accounting and Financial Management Service (AFMS), policy, and ED's Office of Inspector General (OIG), in defining contract requirements and in development and testing of the new system
- Terms and requirements in the contract that did not accurately reflect the Department's expectations
- Requirements creep (failure to cut off requirements definition), which led to delays in the development and implementation of the system
- An incomplete understanding of contracting, particularly the loan origination contract and the terms and limits placed on the Direct Loan staff working with the contractors (Direct Loan staff other than the COTR provided direction to the contractor imposed requirements on the contract "without appropriate contract vehicles," according to one ED representative).

[2] McCormick, Joe, *Dear Colleague Letter, Update 20* (May 2, 1997).

See the section on Contract Management for further discussion.

One ED official noted that in fairness to EDS, there have been no long-term plans made by ED managers and that "the management approach for the past year can best be described as 'winging it' and dealing with one crisis after another." Another official described ED's approach as a "Band-Aid" treatment because backup and contingency plans were not in place. As described above, numerous last-minute changes in requirements affected EDS's ability to deliver the loan origination system. The Department was in a crisis management mode for much of the loan origination development, testing, and implementation, and according to one ED representative, "planning, although a basic and simple concept, would take care of a considerable amount of problems for ED." Another ED official noted that "the Department needs to plan for system turnover in such a way that sufficient development and conversion time is allotted to new contractors."

ED and EDS Needed More Experienced Staff Focused on the Right Things

Many ED officials noted that the Department lacks an adequate number of technical and experienced staff to support and oversee the contractor's activities in developing, implementing, and maintaining the loan origination system. This is in contrast to the successful implementation of the old LOC in a shorter timeframe. ED officials believe that the main reason for this contrast is that AFSA had previous loan servicing experience in the FFEL Program, while EDS did not have any loan servicing experience.

Largely because of a lack of qualified staff, some ED officials felt that the Department failed to effectively plan for the transition, that the Department's internal control process was inadequate, and that the loan origination contract was not properly monitored or managed. (The lack of staff expertise is not surprising, since the Department, prior to implementing the Direct Loan Program, had had little direct experience with loan origination processes and systems.) One ED official asserted, however, that perhaps the Department is focused on the wrong things and is micromanaging contractors—inhibiting them from delivering their expertise by overdirecting their efforts.

Some ED officials noted that EDS did not (and still does not) have an adequate number of staff and that they were lacking in financial aid experience. (EDS has since recruited staff with this type of experience.) Shortage of qualified staff was especially apparent during the testing and implementation phases. Furthermore, ED and EDS did not really forge an amicable working relationship until recently. ED staff felt that EDS's culture was not nearly as flexible as was required to accommodate changes and to provide problem resolution and adjustments for schools.

Lack of Reporting Hindered ED's Ability to Manage Loan Origination

The Department's ability to effectively manage loan origination is hindered by the lack of MIS reports. Department officials noted that EDS has provided virtually no MIS reports, despite

the fact that they represent a contractual requirement and were produced by the former LOC. However, several reports have recently been developed, and the Department and EDS are in the process of finalizing these reports. However, ED staff reported that progress on the development of these reports has been inadequate, and all Department divisions that work with the program as well as participating schools, have suffered greatly due to the lack of reports.

EDS's Customer Service Was a Problem

It is the general perception among ED officials that EDS's customer service was inadequate, owing to a lack of training in basic customer service, a lack of experience in the Direct Loan program, and a lack of responsiveness in following up with customers. Despite plans for knowledge transfer—information from CDSI/AFSA was provided to the EDS representatives, and CDSI/AFSA school relations people were on the ground in Montgomery for several months helping answer telephones—EDS's customer service representatives seemed ill prepared to address customers' questions. One ED official noted that EDS needed a different kind of customer service representative with more systems awareness and technical proficiency. However, another ED official suggested that the Department's expectations regarding the level and type of customer service were based on CDSI/AFSA's customer service for a much smaller population of schools and with greater funds, where much more individualized attention to a particular school's problems was possible.

EDS has acknowledged its weaknesses in the customer service area and is taking steps to address the problems. In May 1997, EDS's vice president sent a letter to Direct Loan participants apologizing for the failure to return calls in the time indicated and for unprofessional treatment by the LOC staff.

Loan Origination Had Some Successes

Despite the transition problems, a number of successes were evident in 1995-96 and 1996-97:

- Since more schools have more experience in administering Direct Loans, the process has run more smoothly
- EDExpress software was upgraded to Windows and is significantly more user friendly
- Meetings with third-party software servicers and vendors were conducted for the first time to discuss information specific to this market segment
- Through February 1997, customer satisfaction with loan origination continued to receive favorable feedback.

Even while acknowledging the LOC's startup difficulties, ED officials believe that the current LOC will ultimately be better than the former. There is the perception among ED officials that

the EDS loan origination system is more technologically advanced because it is based on a relational database and it builds in more rigorous quality assurance (data quality checks, data edits, data communication links) and enhanced reporting. One ED official said that EDS's system "might be [the] best of [the] breed." Furthermore, according to one ED official, representatives from the Coalition of Direct Loan Schools recently visited the EDS facility to see the system's capabilities (e.g., online access and operating modules) and were pleased with its potential.

Future Concerns

One respondent commented that the conversion has been a "programmatic and public relations nightmare." An ED official expressed concern that the low number of schools signing participation agreements to become Direct Loan schools for Year 4 may in fact be related to recent technical problems and concern about the viability of the program. Furthermore, as a result of the problems encountered during the first 3 months of operation, there was great concern among the Direct Loan schools that the new loan origination system would not operate successfully when confronted with the large volume of loan origination activity in the July-September 1997 timeframe.

Recommendations

Recommendations regarding loan origination:

- Include performance measures and regular monitoring and reporting mechanisms; and benchmarks to compare operational performance in the loan origination contracts. Include reporting problems and their resolution, along with action item tracking.

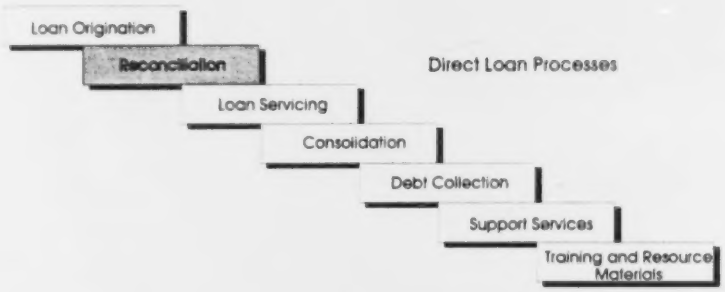
- Conduct exit interviews of institutions that voluntarily leave the program to assess customer satisfaction.

- Assess the LOC's ability to handle the anticipated volume peaks and develop and implement a staffing and training plan to accommodate those needs.

- Develop "lessons learned" from the loan origination transition experience from the following perspectives to benefit future efforts in Direct Loan and other ED systems/processes: program planning, systems planning, development and testing, and contracting. For instance, on the basis of lessons learned from loan origination, the Department may wish to revisit its specifications for and management of systems testing.

- Make sure that the new LOC duplicates the one-on-one service that was available from the old LOC. Case study schools indicated that they are most comfortable when establishing and maintaining a primary support service contact.

Reconciliation



Direct Loan reconciliation is a process that is different from FFEL. Reconciliation is the process by which school-based loan disbursement data are balanced against the LOC's data. Schools reconcile two types of records: cash records and loan detail records. Reconciliation is meant to serve as a quality control function to ensure fiscal integrity. In contrast to FFEL—which has experienced delays in data exchange among schools, lenders, guaranty agencies, and the Department—Direct Lending was designed to provide real-time data to the Department directly from schools. An expected goal is that Direct Loan data will be of high quality, owing in large part to the reconciliation process.

Although the Direct Loan software (EDExpress) allows for areas of flexibility in reconciliation processing, the program implicitly establishes a specific ordering of some events and actions. That order was not always made explicit in instructions to schools or in training. Table II-3 (below) summarizes "ideal" sequencing of the loan processing steps determined through case study site visits and through observation at ED training sessions. Although serious consequences may not result from some steps being performed out of sequence, the possibility of major errors will be greatly minimized if this sequence is followed.

Table II-3

Suggested Sequence of Loan Processing Actions

1.	Create origination record
2.	Generate promissory note; send it to student
3.	Transmit origination records to LOC
4.	Mail signed promissory note to LOC
5.	Receive acknowledgment of origination record from LOC
6.	Receive acknowledgment of promissory note from LOC
7.	Draw down cash
8.	Disburse funds
9.	Transmit disbursement record to LOC
10.	Receive acknowledgment of disbursement from LOC
11.	Make changes in loan amount
12.	Receive and correct loan change/cancellation acknowledgment report errors
13.	Reconcile

Case Study Summary Report, Program Year Two of the Direct Loan Program, Macro International Inc., May 1996.

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There were significant developments in the Direct Loan reconciliation process in 1996-97, including

- Continued evolution of the reconciliation process toward a real-time LOC-based process in which monthly account statements similar to bank statements will be used by schools and ED to perform reconciliation.

- Improvements in technical service to schools, including updated manuals, changes in reconciliation training, first full year of operation of the Accountability and Reconciliation Team (ART), onsite technical assistance, and the enhancement of MIS reports. ED also developed procedures to reduce the complexity of the reconciliation process, streamlining data matching between the schools and loan origination systems.

- Dramatic differences in the way the reconciliation process operated during the first part of the 1996-97 academic year under the former LOC and the latter part of the academic year under the current LOC. Current LOC operational failures include conversion problems, inability to produce MIS reports for schools, and an inadequate control system.

The following discussion centers on reconciliation accomplishments, changes, and issues during the 1996-97 academic year.

Institutional Knowledge of Reconciliation Process Improved Greatly

Year 2 and Year 3 schools experienced dramatic differences in reconciliation in comparison with Year 1 schools. During 1994-95 (Year 1 of the program), reconciliation problems occurred because of software problems, lack of training, and limited understanding of the reconciliation process.

Prior to the LOC conversion, Macro found that Year 2 and Year 3 case study schools either were completely up to date or were in the process of correcting a few rejected records. Data received from ED supported this finding. Reasons stated for the improvement in the process included 1) elimination of bugs in the software; 2) more comprehensive training; and 3) greater emphasis on the process by ED. In addition, until March 1997, improvements were made in getting MIS data electronically for reconciliation.

Delays in Reconciliation Processing at the New Loan Origination Contractor

Among the most significant problems experienced at the new LOC was reconciliation. Processing delays began in March and lasted well into May 1997. As a result, case study schools indicated a high level of frustration with the transition. Representative comments from case study schools regarding problems resulting from the transition included the

following (all case study schools were visited in the spring of 1997, in the midst of the transition):

- "By the end of the first semester [fall 1996], all but two loans were reconciled. [We] haven't been able to reconcile since the transition to the current LOC."

- "The LOC needs to get [the problems] taken care of within 2 or 3 weeks . . . ED can't afford to have [the] perception [that the LOC is not functioning] out there. The Task Force thinks things are taken care of when they are not . . . This really reflects poorly on the Department of Education."

- One respondent commented, "The current loan origination contractor got off on the wrong foot with processing reconciliation files submitted by schools and has been scrambling to catch up ever since. This led to many complications for schools and has forced the Department to make regulatory and procedural exemptions"; another asked, "I am wondering how the conversion fiasco (converting cash data from Year 2 to Year 3) has impacted on reconciliation as a whole for Year 3?"

Followup telephone conversations with case study schools determined that the reconciliation process with the new LOC assumed normal operations by late spring 1997. Schools were pleased with the process once the LOC-based problems had been resolved but indicated that delays created an increased administrative burden when trying to close out the books for the 1996-97 academic year.

Unanticipated Problems Affected the Reconciliation Process

According to an ED official, the main reason that reconciliation was delayed was because of the data conversion between the former and current LOCs. This record file was "huge"; and because of the nature of the conversion, over 600,000 records needed to be handled manually. The extent of this problem was so acute that members of the quality control contractor worked onsite at the LOC full time for more than 1½ months before the process was complete.

The reconciliation system at the LOC became operational in April 1997. Schools were not able to process reconciliation records prior to this date. ED recently indicated that reconciliation processing is now current and they are "processing what they get in the door." Acknowledgments from the LOC are now being processed in 1 to 2 days if no records need to be researched manually. If records need to be researched manually, the stated turnaround time is 5 days (compared to a benchmark of 3 days at the former LOC).

We were told that the current LOC is still in the midst of programming its systems to process outstanding Year 2 and Year 3 records, and no timetable was given for the completion of the programming. Because of the unresolved problems, ED recently extended the closeout period

of Year 2 and Year 3 records to July 31, 1998. This represents a potential problem from a fiscal control standpoint, according to ED's Office of the Inspector General. All Year 1 records were completed by November 22, 1996. Beginning in 1997-98, there will be separate cash files for each program year.

ED Is Taking Action to Address Reconciliation

The Direct Loan Task Force formed the Accountability and Reconciliation Team (ART) in March 1996 to address reconciliation issues at the institutional level. Its function was intended to be one of helping schools properly originate loans and organize data in preparation for reconciling loans. This effort represented a new way in looking at reconciliation in the larger context of the loan process. This team includes ED staff members, Client Account Managers, and ED contractor staff, including the LOC, the software contractor, and the quality control contractor.

The ART's purpose is to gather information and reports—mainly from the Office of Postsecondary Education's (OPE) AFMS—regarding school reconciliation. They formulated two primary measures that indicate whether schools are accurate and up to date with the reconciliation process. These measures correspond to the two main problems that schools have with reconciliation: falling behind in submitting disbursement records and having too much excess cash on hand. The indicators are

- Excess cash on hand;
- Disbursement records as a ratio to drawdowns.

The first indicator is examined both in terms of total dollar amounts and also as a percentage of total volume at a particular school. The second indicator is taken as a percentage of total loan volume. If one or both of the measures are not at the appropriate level for a particular institution (as determined by the ART), ART personnel then analyze the data and deploy an intervention strategy.

The threshold standards used are a disbursement-to-drawdown ratio of 90 percent or more and a cash balance of $1,000,000 or less. Additional standards are currently being developed. At certain times of the year, schools are more heavily involved with processing borrowers, and this may result in a delay in submitting disbursement records. This is taken into account when determining potential "penalties" for a school, but the standards remain the same throughout the year.

The ART group serves as a coordination point for reconciliation. The group provides guidance to other customer service/technical-assistance groups, such as the Account Managers and contractors' customer service units. In addition to intervening on schools' behalf, the ART is addressing the communication flow between schools, ED, the Servicer, and the

Account Managers. For example, in order to assist schools with reconciliation problems, ART members would like to develop clearer guidelines as to whether a school should contact the LOC or the Account Managers about a problem or an issue.

According to one ART member, problems with the reconciliation process at the institutional level fall into one of three broad categories: hardware, software, and institutional issues. Table II-4 identifies issues and ART's corresponding actions.

Table II-4

Accountability and Reconciliation Team's Issue Resolution

Category	Issue	Solution
Hardware (non-ED systems)	Vendor-provided software—delays, programming problems, etc. Mainframe schools not following ED-provided technical guides when duplicating EDExpress functions on internal systems Schools using a combination of ED-provided software and mainframe system—causes delays in processing, etc.	ART coordinates with the software contractor and the LOC, who then contact school programmers to guide them through problems
Software	Conversion to EDExpress	ART coordinates with the software contractor and the LOC, who then assist schools with conversion
Institutional	Staff turnover Not enough staff, or wrong staff sent to Direct Loan training	Account Managers conduct telephone intervention or (if necessary) visit sites to conduct in-person training.

An ED official indicated that during the first year of Direct Loan administration, ED staff members focused on matching the total cash records. Beginning in 1995-96, ED switched its priority to the three steps required to book the loans,[3] with an emphasis on sending disbursement records to the LOC before performing reconciliation. Accordingly, ED has emphasized the importance of completing all steps in the proper sequence prior to attempting to reconcile. ED staff are also focusing on the disbursement process. This ED official and ART members said that all major problems that have affected reconciliation have been

[3] In order to book a loan, an institution must send in three components to the LOC: the loan origination record, the promissory note, and the disbursement record.

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addressed. Now, the primary message they are relaying to schools is the importance of reconciliation and the ease with which the process can be implemented if the correct sequencing steps are followed.

Thirty-Day-Reporting-Requirement Regulations To Be Enforced

Direct Lending regulations state that schools have to complete their monthly reconciliation (including submission of all electronic records and promissory notes) within 30 days. Consistent with ED's original intent, the function of the ART was placed in the Accounting and Financial Management Services (AFMS) area in summer 1997. The focus under AFMS will be reviewing schools that have not met the 30-day reporting requirement. Schools that continually do not meet this date may have their origination level changed and/or be referred to IPOS. ED staff are now addressing the circumstances under which the Department should intervene for schools that have not complied with this regulation and are not demonstrating sound management of the program. As of October 1997, two of the three key members of ART have moved to AFMS, and the third key member, while still on the Task Force, has been acting in an advisory capacity. In addition, the ART group will continue to rely on certain Account Managers who have been involved with ART since the beginning. These actions should enhance the capability of the ART.

More Consistent Data Accessibility and Reliability Are Needed

The triggers that ART uses to initiate corrective action with a school are cash balance on hand and disbursement-to-drawdown ratio. The team gets this information from a central database through the Payment Management System (PMS) and Financial Accounting Reporting System (FARS) (booked loans). They got the first 30-day reports[4] in November/December 1996, approximately 6 months after formation. However, they have not gotten any information since the current LOC came online.

Another problem is that the current LOC has been slow in developing and generating MIS reports, which schools—and the Department—have come to rely upon for assistance in reconciling cash and loan detail. These reports indicate to schools which loans have been successfully reconciled and which have not. For loans that have not been reconciled, these reports indicate error codes, which enable schools to correct reconciliation records prior to resubmitting to the LOC.

Despite the problems experienced by the current LOC with the reconciliation process, numerous ED officials believe that the reconciliation process will eventually be improved.

[4] 30-day reports indicate whether a school has submitted their monthly reconciliation in the required 30-day period. The reports are used by ART members to look for trends and difficulties experienced by schools in the reconciliation process.

The current LOC has built edit checks into the system that had not been there before. These edit checks will prevent reconciliation records that contain errors from ever being sent to the LOC. Under the former LOC, system edits were not in place. Thus, reconciliation records with errors were often corrected manually at the LOC rather than being flagged electronically and sent back to schools for correction and resubmission. An ED official believes that schools are not happy with the current arrangement because they are losing the "handholding" that they received from the former LOC that allowed them to have reconciliation records corrected at the LOC without having to correct and resubmit them.

Substantial Changes in Reconciliation Are Planned for 1997-98 and 1998-99

ED officials described substantial changes in the reconciliation process beginning in the 1997-98 academic year (Program Year 4). These changes are part of the intended evolution of the reconciliation process toward a real-time, LOC-housed process in which monthly account statements similar to bank statements will be used by schools and ED to perform reconciliation.

Beginning in 1997-98, the reconciliation process will be housed in the loan origination system rather than the accounting subsystem (FARS). Moving this function to the loan origination system will enable schools to download information to the LOC much more easily, because the files should be smaller. From a systems perspective, combining the reconciliation function with the loan origination subsystem will give ED a far better quality assurance and reporting mechanism.

The Department has implemented new data edits that are intended to streamline the reconciliation process for 1997-98. The new process, if done in the proper sequence by schools, will enable schools to automatically reconcile loan records as they book loans. This sequence will consist of schools sending in the promissory note and loan origination record to the LOC. If these components are approved by the LOC before the school requests the disbursement, then the record will be considered reconciled and will not appear on the reconciliation roster. New edits have been built into EDExpress to accommodate this streamlined process. In addition, the disbursement record will be considered reconciled if either the disbursement record or the promissory note results in the loan being booked.

Beginning with 1998-99 academic year, the reconciliation process will change. Schools will receive a monthly statement from the LOC that reports to the schools their cash balance on the basis of disbursement and cash activities reported to the LOC. If a cash balance is greater than zero, it indicates that a school has not disbursed or returned all drawn-down funds. Schools are required to reconcile the cash balance reported to them by the LOC with their internal records. The Department (AFMS' ART) will monitor the school cash balances and contact schools whose cash balance is significantly greater than zero on a continuous basis.

This statement, the Direct Loan School Account Statement (DLSAS), will be produced by the LOC and will be sent to schools monthly. The school will be responsible for resolving all discrepancies. The statement will include both cash balance and loan detail information, but schools will not be required to resolve individual loan records on the basis of various error codes, as they currently do. Instead, this process is designed for schools to be able to resolve reconciliation by running queries on EDExpress. According to an ED official, this new procedure will streamline the reconciliation process and make it more user friendly.

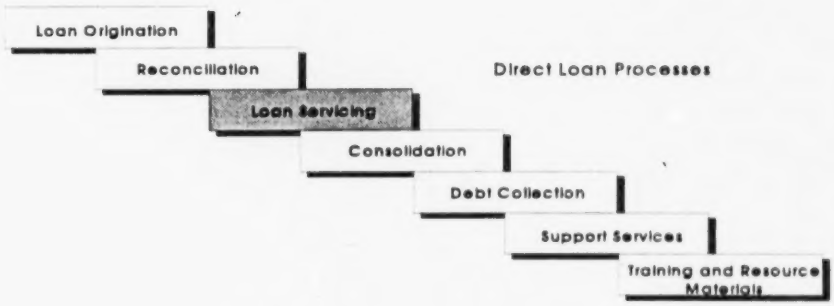
Recommendations

Recommendations in the reconciliation area:

- Follow up on the promise to enforce regulations such as the 30-day reporting requirement. Work with the Institutional Participation and Oversight Service (IPOS) to take corrective action against schools that are not in compliance with regulations.

- Certain Client Account Managers have acquired a strong background in the reconciliation process. Allow them to continue focusing on this process in order to assist schools in understanding the process and deciding what actions need to be taken to ensure success with reconciliation.

Loan Servicing



Servicing during 1995-96 and 1996-97 became increasingly more complex than 1994-95 servicing operations because of the substantial increase in loan volume and number of borrowers. The increases caused support requirements in the customer service and servicing technical areas to grow substantially, placing heavy performance burdens on the Servicer. The increase in loan volume and borrowers had been mostly anticipated, however, and plans developed in Year 1 proved to be basically adequate in Year 2. Of particular significance to the relatively smooth servicing operations was the collaboration between the Servicer and ED staff in the systems, customer service, and default prevention areas, due in large part to the improved communication between the groups from Year 1 to Year 2. The following discussion covers accomplishments, issues, and plans for servicing in Year 3 of the program.

As the Direct Loan Program ends its third complete year of operation, the number of borrowers and the loan volume in repayment have reached significant levels. Approximately 900,000 borrowers, representing $6.8 billion in Direct Loans, are currently in repayment.[5] Current loan volume in repayment makes the Department of Education (ED) the second-largest servicer of student loans in the country.

An ED official noted that unlike the loan origination phase and the matriculation of borrowers from in-school to repayment status, Direct Loan borrowers have not "lived through" loan servicing. Therefore, this official believes that at least 2 more years need to pass before servicing data can be fairly evaluated. The focus of this section is the actions regarding ED's contract management strategies in the area of servicing in 1996-97.

[5] "Dear Colleague" letter, October 1, 1997.

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ED Awarded Contracts to Three New Loan Servicing Centers

For the first 3 years of the Direct Loan Program (i.e., from the 1994-95 through the 1996-97 academic year), the AFSA corporation, a subcontractor to CDSI, was the sole servicer of Direct Loans.[6] Contracts for three additional servicers were awarded in September 1996 to the following groups:

1) Electronic Data Systems (EDS), with Kentucky Higher Education Loan Servicing Company

2) Raytheon/E-systems, with Great Lakes HESC

3) ELSC (USA Group), with C&A (partnership of CDSI and AFSA) .

Each of the three new servicing teams had extensive experience in servicing FFELP loans, especially in the critical areas of large-scale systems development and customer service. Each new servicer will modify existing FFELP systems rather than build new systems from scratch. These systems will have some new features, such as additional "tiers" (signifying a more complex operating system) and more advanced skip tracing functions. The practice of using existing loan servicing experience and expertise was cited by an ED official as a positive development.

Although outside organizations have questioned whether ED needed to award three additional servicing contracts in view of the loan volume, an ED official said that the Department's intent was for the loan servicing contracts to achieve the cost savings and performance enhancements that result from competitive servicing. However, another ED official believes that the decision to award contracts to multiple servicers should lead to "substantial improvements in timeliness and quality of loan servicing for borrowers."

On October 1, 1997, ED announced that it decided to remain with CDSI/AFSA as the servicer for all Direct Loans. The stated reasons for this decision were servicing capacity, cost, and efficient oversight and contract management.[7] None of the three contracts had begun to service loans and they had not completed all testing.

At the time of this decision, none of the three contracts had begun to service loans. However, the Department spent upwards of $40 million dollars prior to its decision to cancel the contracts.

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[6] CDSI/AFSA will maintain its current Direct Loan servicing portfolio through the 1996-97 academic year. It will not pick up any additional loan servicing volume but will service current loans through their life cycle. In addition, CDSI/AFSA will not participate in the performance-based contract provisions.

[7] Dear Colleague Letter, October 1, 1997.

In writing the Request for Proposals (RFP), ED officials intended for these contracts to be based largely on a performance-based model. The premise of this model was to propose a common outcome that would be the same for each of the contractors and allow for different approaches as long as a standard was met. The standard to be met was level of service to Direct Loan borrowers in repayment. As long as this benchmark was being reached, contractors would be able to follow their own innovative approaches to servicing in order to take advantage of their strengths and capabilities.

The Department built some incentives into the solicitation. For example, ED placed an emphasis on default prevention, encouraging contractors to propose innovative ways of monitoring and setting standards for default prevention. As a result, the Department received varying approaches to default management from the three servicers.

However, after awarding the contracts, ED moved away from this approach. Instead, once the contracts were awarded, ED provided contractors with stringent business rules. For example, after indicating to contractors that the only requirement for written correspondence to borrowers would be that final versions had to be approved by ED, rules were issued dictating the exact language and even the font type for the letters. An ED official who works directly with one of the new servicers indicated that this contractor was very good about making the ED-proposed changes but commented about the lateness of the changes (especially since the new servicers had 10 months, a relatively brief period of time, following the contract award, to implement the new systems).

Some ED personnel feel that moving from a performance-based contracting system to a system of contract management that is based on control, and that following the statement of work will result in a lack of innovation or competition among contractors. The Change would also result in higher costs, a lack of utilization of prior industry experience, and more effort expended by both ED and contractor staff. A staff member commented that ED should have issued the contractual parameters up front, rather than changing approaches after contracts were awarded.

ED Technical Staffing for Oversight of Servicing Contract Remains a Question

As reported by several ED officials, there is a shortage of staff with systems background at ED to manage the servicing contract. Although this has already caused problems, as more loans go into repayment ED will be increasingly challenged to provide adequate oversight for servicing operations. Because they are short staffed, many staff members are having to perform multiple roles.

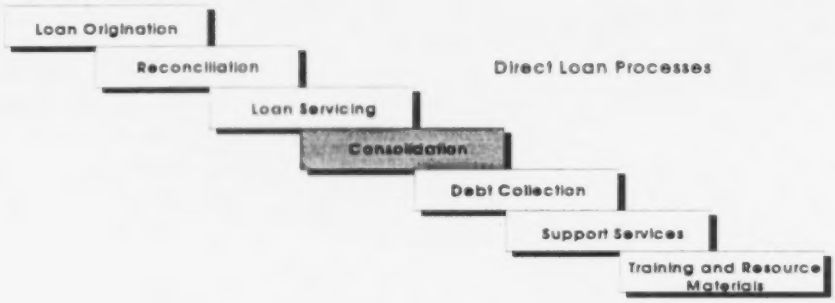
However, a positive step in gaining a level of expertise with the servicing process was the hiring of two additional staff members with extensive FFELP servicing experience. These new Task Force members will be able to share their knowledge and expertise with other ED officials.

Further discussion of staffing issues at the Department is contained in the Organizational Management section in Chapter III.

Recommendations

Recommendations for loan servicing: address training issues for customer service staff. It is especially important either that training on complex technical issues be offered or that those questions be diverted to more qualified technical personnel.

Consolidation



Under Direct Loan consolidation, borrowers may combine multiple loans (such as FFEL, Perkins, and Direct Loans) and make one payment to one lender—the Department of Education. The borrower initiates the process by contacting the loan origination center to obtain a loan consolidation application and promissory note. When the completed application and promissory note have been received from the borrower, the LOC contacts the loan holders (or servicers) to pay off the loans that the borrower wishes to consolidate. After this transfer of funds has taken place, terms of the new consolidated loan are calculated at the LOC and the borrower begins repayment of the consolidated loan to the ED by making payments to the LOC.

ED transitioned Direct Loan consolidation to the new LOC in Montgomery, Alabama, on September 16, 1996 (prior to bringing up the origination process). Although fully implemented in 1995-96, consolidation was under tremendous public scrutiny because of customer dissatisfaction with the time it took to process consolidation applications. The following discussion focuses on several consolidation issues: customers' dissatisfaction, data integrity, and the consolidation process itself.

Customers Are Dissatisfied With the Length of Time It Takes To Consolidate Loans

The Department had targeted 60 to 90 days to complete the consolidation process from beginning to end. However, many consolidation applications are taking much longer. The National Association of Student Financial Aid Administrators (NASFAA) notes that "students desiring a Direct Consolidation Loan have experienced an average turnaround of 142 days due to unanticipated volume coupled with difficulties stemming from a transfer of operations between contractors."[8] The House of Representatives Subcommittee on Oversight and

[8] News from NASFAA (August 1, 1997).

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Investigations, Committee on Education and the Workforce "has been told by a number of FDSLP schools that consolidations in the FDSLP are now taking in excess of 180 days."[9]

The stated reason for the extensive delay in the consolidation process was that the system inherited by the current LOC was not easily adaptable. Because of data problems such as incomplete loan information for borrowers who applied for consolidation loans, much of the process had to be performed manually. ED officials also indicated that ED and the LOC did not anticipate the amount of consolidation application volume that they received and were understaffed.

EDS started with a backlog of approximately 30,000 inquiries regarding consolidation. The backlog of inquiries were further exacerbated by increases in the volume of applications received every month—the Department notes that EDS was averaging 5,000 more consolidation applications each month since assuming consolidation responsibilities in September 1996.

The Subcommittee on Oversight and Investigations has received complaints about substantial delays in processing loan consolidation requests from students and schools participating in FDSLP. Many customers were clearly unhappy and dissatisfied with the level of service provided. (It is not clear how satisfied customers were prior to the transition.)

ED Transitioned Consolidation to the New Loan Origination Contractor

ED transitioned consolidation to the new LOC in September 1996. Although EDS passed all phases of testing (according to several ED officials), there were still problems during implementation. Furthermore, EDS started with a backlog of approximately 30,000 consolidation applications from CDSI/AFSA, which had also experienced difficulty in handling consolidation. (CDSI's consolidation system was developed in FoxPro, was housed on a personal computer, and had trouble even handling a much smaller volume of consolidation applications.)

The Department noted that it delayed the start of the EDS contract twice—for almost 8 months—to ensure that EDS was ready. ED also directed a change in EDS's project management, imposed critical milestones, and withheld additional development funds until after the system became operational. One ED official asserts that EDS's consolidation system tested well and met all the terms imposed in order to go online. During the implementation period, customer service staff were totally restructured. Just recently, EDS customer service representatives from the servicer side (in Kentucky) have been asked to address customers' consolidation issues. Approximately four thousand calls come in to the LOC daily—many of which are from customers requesting the status on applications in backlog.

[9] Subcommittee on Oversight and Investigations (June 12, 1997).

The Department has further heightened its oversight of EDS's performance by implementing independent quality control reports and regularly involving senior management in meetings and contractual responsibilities.[10] EDS is still working off the backlog, but new applications were being processed in a much shorter timeframe. An ED official noted that approximately one-quarter of the incoming consolidation applications are completed in 60 to 90 days.

Despite these oversight measures, on August 26, 1997, senior ED officials informed the Subcommittee on Oversight and Investigations, Committee on Education and the Workforce that the Department will no longer be accepting applications for consolidating loans for an "undetermined period of time."[11] The reason given for the indefinite shutdown was to clear the backlog of applications and the need for greater accountability for the payments that the Department is making on behalf of students.[12]

This was the second time in less than 2 months that the loan consolidation process was shut down due to the breakdowns in the system. As of July 23, 1997, more than 70,000 applicants were "in process" by EDS. ED is notifying these applicants of this delay by letter.

The Department Has Been Ill Prepared To Deliver Consolidation

It was noted by ED staff that since the program began, ED has underestimated what it would take in both internal and external resources to accomplish consolidation. The Department invested little planning in getting consolidation up at CDSI/AFSA and may still be suffering the consequences.

One ED official suggested that consolidation always takes a second seat to origination at the Department and that schools, rather than borrowers, are seen as ED's primary customers. Because of that focus, ED has not committed the management attention or the resources required to step up and manage consolidation. However, another ED official noted that the fact that management had recognized consolidation as a distinct process requiring resources and attention was a good sign.

Lack of Reporting Hinders ED's Ability to Manage Consolidation

Like origination, ED's ability to effectively manage consolidation is hindered by the lack of management information systems (MIS) reports. These reports contain information about loan amounts and interest rates. Recently, the Department asked EDS to provide a contractor resource at ED to serve as an information conduit.

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[10] Ibid.

[11] Hoekstra letter to Secretary Riley (August 28, 1997)

[12] The LOC eliminated the application backlog and resumed normal consolidation activities on December 1, 1997.

Issues of Data Integrity Compound Problems of Consolidation

There have been some serious data integrity issues in the Direct Loan consolidation process—some original loan holders have not been properly paid. The Student Loan Fund of Idaho Marketing Association notes that "out of the 41 borrowers, two were not paid at all, 15 were underpaid and 19 were overpaid. Only five of the accounts were paid in full appropriately."[13] One external stakeholder has been concerned that improper payment could result in inaccurate information—for thousands of loan holders—about what is owed to the Department.[14] In response to problems with inacurate loan amounts, the Department's Office of Inspector General (OIG) conducted an audit of a representative sample of Direct Loan schools in 1996-97. This audit disclosed weaknesses in a number of areas including: student status reporting; electronic data processing (EDP) controls; loan record accuracy; timeliness of reporting; cash management; and reconciliation.[15]

The Consolidation Process Is Flawed

Although EDS's consolidation process is designed to automate aspects of the process (e.g., automation of edits), ED officials noted that several aspects of the consolidation process were fundamentally flawed. One ED official suggested that the certification of loan amounts at banks be automated. Another ED official noted that breaking up the promissory note from the application has added a step, which takes longer—and sometimes results in lost customers. Furthermore, because of edit checking, most applications go into exception processing, a very manual process with multiple handoffs.

Consolidating multiple loans is a complicated process. The average consolidated loan is upwards of $15,000 with an average of four underlying loans. Both the Department and EDS have recognized the need to address fundamental problems in the consolidation process itself—the process needs to be improved and streamlined so it can accommodate the potential volume of loans. The Department plans to embark on a reengineering of the consolidation process. ED reported that EDS developed a initial set of suggestions to improve the process, and then Price Waterhouse conducted an assessment of the process and provided the Department with recommendations (e.g., a more automated interface with loan holders, use of NSLDS to do lookups, putting the loan consolidation application out on the Web like Sallie Mae, a Web application based on NSLDS). The Department and EDS are now developing an action plan. Further, as part of renegotiating the contract and pricing with EDS, the Department plans to rewrite the contract to include specific performance measures regarding consolidation.

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[13] Representative Hoekstra letter to Secretary Riley (July 23, 1997).

[14] Ibid.

[15] Office of Inspector General, *Administration of the William D. Ford Direct Loan Program by Schools—Final Report*, October 1997.

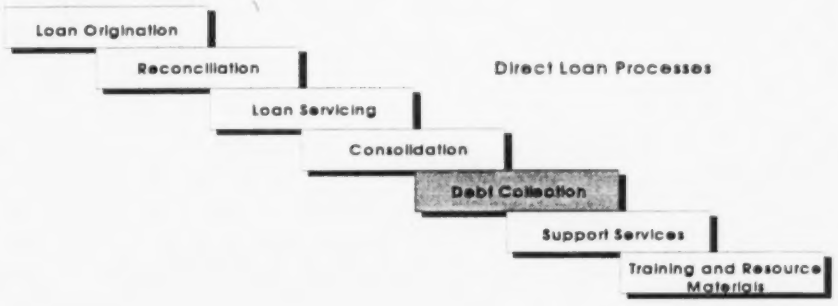
Other efforts under way include the redesign of the consolidation application, which is on hold pending the action plan for reengineering.

Recommendations

Recommendations for the Direct Loan consolidation process:

- Address data integrity problems immediately.
- Dedicate the appropriate resources to implementing the reengineering action plan as soon as possible.
- Develop and implement performance measures and regular monitoring and reporting mechanisms; seek benchmarks to compare operational performance. Include reporting problems, their resolution, and action item tracking.
- Develop "lessons learned" from the consolidation experience to benefit future efforts in Direct Loan and other ED systems/processes.

Debt Collection



The debt collection process specific to Direct Loans is still in its infancy. The student loan debt collection process, however, is one that ED has significant experience with and has developed and improved debt collection for its other loan programs, including the current FFEL Program. For all loan programs, total collections on defaults have more than doubled in the past 4 fiscal years, from $1 billion in FY 1992 to $2.2 billion in FY 1996. Increased collections have resulted from efforts at guaranty agencies, ED, and other Federal agencies, including the Internal Revenue Service (IRS) as well as through the consolidation of FFELP Loans into the Department's Debt Collection Service Direct Lending portfolio. ED has several avenues of collection, including commercial collection contractors, the offset of Federal income tax refunds, wage garnishment, Federal salary offset, and Federal lawsuits against student defaulters. Some of these collection tools have resulted from regulatory changes giving ED broader authority to collect from defaulted borrowers. ED reports the following statistics regarding its success with some of its debt collection tools:

- In FY 1996, $535 million was recovered through the offset of Federal income tax refunds from 573,000 defaulters.
- Wage garnishment increased from 5,000 defaulters in FY 1995 to 25,000 in FY 1996.
- Federal lawsuits against defaulters increased from 200 accounts in FY 1995 to more than 8,000 in FY 1996.

Additionally, through the first 9 months of FY 1997, approximately $480 million had already been collected through the withholding of Federal income tax offsets.

ED has prepared its debt collection processes and systems for many of the requirements of Direct Loan activity, such as consolidations and the Income Contingent Repayment Plan (ICR), and has enhancements under way for more advanced functionality, such as loan rehabilitation. This section provides an overview of the process in relation to Direct Lending, offers highlights of ED activities and issues for Year 3 in debt collection, and presents recommendations for future debt collection efforts.

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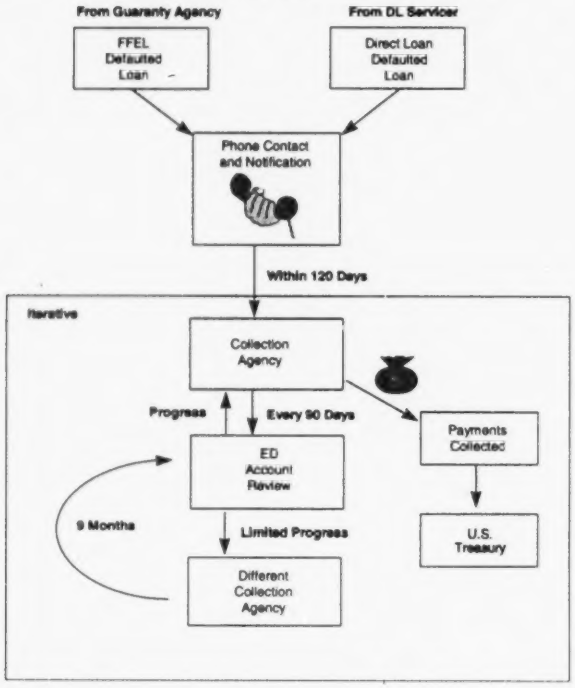
Currently, ED manages approximately $9 billion in defaulted loans through its Debt Collection Service (DCS). This portfolio is composed of about $8.5 billion of FFEL Program loans, $500 million of Perkins defaulted loans, and about $10 million of Direct Loans. As can be seen, Direct Loan defaults have yet to really affect resources or work load. However, ED continues to ready its systems for the new process changes that will affect DCS and has already aligned some processes for Direct Loan requirements.

The Central Process Remains the Same for Direct Lending as for Guaranteed Loans

The debt collection process is fairly simple and remains unchanged whether the loan is Direct or FFELP. Once either type of loan has defaulted, it is handled in the same way. The following exhibit provides an overview of the major process flow for a defaulted loan handled by the DCS.

The defaulted account goes first to a contractor who makes initial telephone contact with the borrower. Next, a written confirmation is mailed offering the borrower the option of paying and informing him or her of the consequences of continued nonpayment. Within 120 days, the account is sent to a collection agency. Every 9 months, the accounts are evaluated by ED for placement. Those that are not performing well are generally recycled to another agency; if progress has been made, then they may stay with the current agency.

Debt Collection Process Overview



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Direct Lending Is a More Efficient Program for Debt Collection

One major difference between the programs is in the sources of the defaulted accounts in ED's DCS. For FFEL Program loans, the sources are currently over 30 guaranty agencies (GAs). The number of GAs has required a significant amount of coordination and communication. For Direct Lending to date, the source has been a single servicer, which has resulted in a smoother process overall. As a result, DCS has fewer logistical problems and a more efficient process. The Direct Loans also get to ED's collection agencies faster than FFELP loans, since a GA attempts collection on FFELP loans for at least 180 days before turning them over to ED, while the Direct Loans are more immediate. DCS has presented this "fresher paper" concept to the collection agency industry as a potential reason for decreasing collection commissions in the future, the idea being that there may be greater potential to get the borrower into repayment in the earliest stages of delinquency/default. The collection agencies may expend less effort to collect, and some of that savings could be passed on to the Department through reduced commissions.

Lower Default Levels for Direct Loans Are as Yet Not Measurable

The notion that Direct Loans will have fewer defaults has yet to be proven. With comparatively lower loan volume in repayment status, and most of that in the first year of repayment, it is still too early to tell. The most mature loans in repayment are PLUS loans, which typically represent the lowest default levels, on the basis of FFELP experience. Perceptions within the Department are that there will still be defaults, and currently they are expected, for budget purposes, to be at levels similar to FFELP, despite the ICR options. Some believed at program inception that the ICR option would basically eliminate defaults. That has not been the case. For FY 1996, loan volume in the Debt Collection System, which tracks all ED defaulted loans, showed more than 15,000 Direct Loans in the system, out of more than 4.5 million for all ED programs. The number is not yet significant, but it does show that defaults will occur despite ICR.[16]

Preliminary estimates indicate that the gross default rate and the loss rate will be slightly lower for Direct Lending than for FFEL.[17] However, the 1996 rates, as currently estimated, are comparable for both programs, with Direct Lending having a slightly lower gross default rate for that year, by 0.8 percent, and essentially the same loss rate.

The stated goal of the Department regarding the Direct Loan default rate is that it will not exceed 10 percent, a rate that is comparable to that of the FFEL Program. Actual Direct Loan target rates have yet to be established, because the program has not yet fully matured, and are not reflective of total population in a mature portfolio. The Department estimates that a minimum of 3 years of default rate issuances is needed to determine the baseline.

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[16] Direct Loans are defaulted at 270 days; FFELP loans are defaulted at 180 days.

[17] The Department of Education defines the gross default rate as the lifetime gross dollar cohort default rate over the life of a loan cohort. The loss rate (lifetime net default rate) projects the overall rate of the Department's liability for a cohort of defaulted loans after taking into account collections on defaulted loans.

It is not yet possible to determine default trends, but ED expects lower default rates because of the following tools used in association with Direct Lending:

- Income contingent repayment plan (ICR)
- Consolidation—regular and in-school
- Debt collection—will include wage garnishments
- Delinquency/Default Prevention Group
- Defaulted loans are identified much earlier by the Department.

Federal Loan Program Gross Default Rate and Loss Rate by Program, 1992-1996				
	Gross Default Rate		Loss Rate	
	Direct Lending Program	FFEL Program	Direct Lending Program	FFEL Program
1992	—	18.9%	—	8.3%
1993	—	18.1%	—	7.9%
1994	14.3%*	17.5%	6.3%*	7.7%
1995	15.3%*	17.4%	6.9%*	7.6%
1996	16.3%*	17.1%	7.4%*	7.5%

*Estimated

Source: U.S. Department of Education Program Performance Plans, Draft for Consultation With Congress, August 22, 1997.

Debt Collection Is a Natural Candidate for Performance-Based Contracting

Debt collection activities by their nature lend themselves to performance-based contracting. DCS has historically used a results-based compensation approach with its contracts. The contractor, who initiates the collection process by making telephone contact with the borrower, is paid $2.50 for each borrower contact. Staff are not paid for the number of telephone calls to a borrower's home or if they leave a message with a relative—they are compensated only for direct borrower contact. Likewise, the collection agencies are paid strictly by commission based on dollars collected, not on the number of accounts attempted. The collection agencies then seek ways to prioritize and target accounts based on ZIP Code, to optimize their ability to collect for the Department, and correspondingly increase their commission revenue.

ED is in the process of issuing new contracts for debt collection services. As previously mentioned, ED is hoping to reduce commission rates through the competitive procurement process. Officials are hoping that the "fresher paper" concept would be incorporated in the agencies' bids. The procurements, as well as existing contracts, are for all ED-defaulted loans; there is no distinction made as to program. Currently there are 13 contracts in place with 7 agencies. The new awards, which are expected to be let before the end of the fiscal year, may be to 10 to 15 agencies. ED officials said that the new procurements have more stringent performance measures built in, beyond for performance. Currently, better performing agencies get more paper, but no metrics drive that process.

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Consolidation of Defaulted Loans Diverted Attention From Other Collection Issues

The transition of Direct Loan consolidations from CDSI to EDS saw a significant level of service deterioration and caused ripple effects in DCS as well. The policy that allows defaulted borrowers to consolidate into the Direct Loan Program brings DCS into this Direct Loan process. Previously CDSI, working with DCS and having direct access to the Guaranteed Student Loan (GSL) System (which houses the Debt Collection module), had developed the defaulted loan consolidation into an efficient 10-day process. This "fast track system" for defaulted consolidation was mentioned by ED officials as a program success for 1996-97. However, the current estimate of the defaulted loan consolidation process is more than three times (at least 30 days) the previous level, with much longer cycle times during the transition period. As of October 1996 the backlog was down from 70,000 to 5,000 loans. Consequently, DCS has had to focus efforts on transition and reworking this process.

Income-Based Repayment for Nonpaying Defaulters Was Viewed as Risky Policy

Some EDS officials have expressed concern that "zero-payment ICRs" may present future delinquency problems and ultimately defaults. Current regulations allow defaulted borrowers to consolidate into Direct Loans and be offered the ICR option. Concern focuses on granting the ICR option to nonpaying borrowers, those who have not made any payments prior to consolidation. There is a concern that ultimately, borrower behavior differs between payers and nonpayers, i.e., those who did not pay before consolidation, also tend not to pay afterward. This, in the long run, will have adverse impacts on the level of defaults experienced in the Direct Loan Program. Also, perhaps offering the ICR option only to the paying defaulters will provide incentive to nonpayers to pay, in effect having the borrower earn the right to more flexible repayment options. The ED OIG also shared similar concerns regarding the risks associated with this policy. ED is currently working with the Office of Management and Budget (OMB) to address this issue.

Debt Collection Systems Appear Ready for Direct Loans

DCS has prepared its systems, primarily the Debt Collection (DC) module of the GSL System, to handle Direct Loan defaults. Staff currently receive information and create records based on servicer records. Additionally, DCS can offer ICR from the Debt Collection module, getting income information from the IRS to base billing on. ED is working on developing DC system enhancements to handle rehabilitations for Direct Loans. There are as yet no rehabilitations for Direct Loans (defaulted loans for which the borrower subsequently makes 12 consecutive payments and negotiates their terms with holder). In Direct Lending, a rehabilitated loan will return to the servicer; FFEL rehabilitated loans go to Sallie Mae or another Government-approved loan servicer.

Debt Collection Service Plans to Focus More on Direct Loans in the Future

Since, as one official mentioned, Direct Loan defaults "are not yet on the radar screen," efforts have focused on developing the capabilities for Direct Lending, rather than on analyzing or improving debt collection processes specific to Direct Lending. ED is considering some improvements, such as defaulted loan scoring, a technique recommended by ED's OIG, where loans are scored based primarily on school type. On the basis of historical borrower (in this case, defaulter) behavior, DCS' efforts should focus and direct more resources on the higher scoring loans, which are more likely to perform.

Recommendations

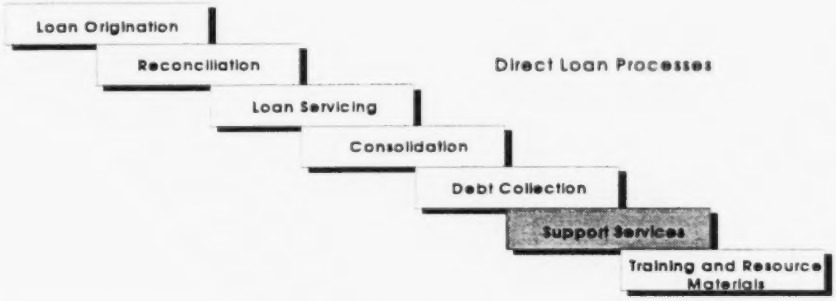
The following are recommendations regarding debt collection:

- As more Direct Loans enter repayment, analyze delinquency, default, and collection trends to determine their comparability with the FFEL Program. Evaluate the ICR option and its impact on defaults. Use this as the basis for any program-specific process improvements.

- Continue to place importance on the student counseling function and introduce initiatives to reduce default rates. Gather research on existing initiatives and disseminate this information to all schools.

- Evaluate the use of tools and methods of implementation, such as debt scoring to improve ultimate collections, and consider whether these are best implemented by ED or through performance-based collection contracts.

Support Services



One of the most important aspects of loan delivery was the high level of customer service and technical support provided by ED and its contractors during the first 2 years of the Direct Loan Program. These customer service efforts included a number of new initiatives, such as enhanced training activities, the ED Bulletin Board System, the World-Wide Web site, and the Regional Office Client Account Managers. During 1996-97, customer service efforts were affected mainly by the transition of the loan origination contract. The following section addresses current customer support efforts.

Case Study Schools Expressed Mixed Feelings About the Former and the Current LOCs

In general, case study schools were satisfied with the support they received from the former LOC. A typical FAO comment was "[the former LOC] is very helpful and able to explain things. We are very satisfied with the services received."

Technical support received from the current LOC was rated less highly than from the former LOC. It should be noted that during the time that Macro conducted site visits in March through May 1997, most LOC operations were delayed or not functioning. Therefore, most schools commented on the assistance they received in trying to ascertain the status of LOC operations rather than more "school-specific" questions. Given these parameters, FAOs had three complaints about LOC customer service staff: 1) Staff were not knowledgeable about financial aid operations, 2) Staff failed to return FAO calls on a timely basis, and 3) LOC staff did not treat FAOs professionally. There were similar problems with the consolidation process (see the Consolidation section for discussion).

ED Intervention Improved Service at Loan Origination Center

ED staff concurred with the opinions expressed by case study institutions regarding the support service provided by EDS. They indicated that, in hindsight, problems with customer service at the current LOC stemmed from lack of familiarity of customer service staff with financial aid and systems, lack of staff training in these areas, and a lack of understanding of what

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schools needed. It was noted that "the [LOC] operation is completely inadequate in meeting customers' needs. The problems with the LOC transition diminished schools' confidence and almost killed the program."

ED staff, including high-level ED officials, did address these issues with the current LOC and made some changes to their technical service delivery, including changing their Voice Response Unit to ensure that schools were better able to reach a representative on a timely basis and establishing a special customer service hotline that provided a point of contact if a school believed it had received unprofessional treatment. In addition, customer support staff were replaced. The Direct Loan Task Force sent out numerous Loan Origination Transition Updates. Case study schools appreciated the effort of the Task Force to keep them informed of issues and the status of the transition through these updates. Macro staff made followup telephone calls to case study schools in May 1997 to find out the status of the LOC. Schools indicated that they were able to process loans through the LOC, and that LOC staff had been helpful in assisting them with this process.

ED's Newest Innovation—Client Account Managers

ED implemented the Regional Office Client Account Manager (CAM) system in February 1995 to provide support to Direct Lending schools in the form of customer service, technical assistance, and training. The 1995–1996 academic year was the first full year of CAM operations.

Interactions between case study schools and CAMs ranged from a single introductory telephone call to frequent interaction for technical assistance (daily communication, in the case of one school). The majority of Direct Lending respondents indicated that contact with the Regional Office was initiated by both institutions and the Regional Offices (72%).

The most timely type of contact with the Regional Offices were requests for ED-provide material (79%), training received at the Regional Office (75%), and questions regarding Direct Loan policy (74%), while the least timely were actually the same as the least useful, computer-related reconciliation issues (55%), accounting-related reconciliation issues (57%), and questions and issues regarding computer system design or implementation (63%). During the 1996-97 academic year, Direct Loan schools were asked to rate services provided by the Regional Offices (Table II-5).

When case study schools were asked what they thought the current role of the CAMs was, their responses varied. Five schools indicated that they serve primarily as a support mechanism on a range of issues, including policy, technical support, LOC and software contractor problems, and troubleshooting and answering questions. One case study school "calls every day" with LOC and software contractor problems. Another school believed the CAMs' role was to make sure schools were "up on all their tasks." Two schools said that their role was primarily one of marketing the program. One proprietary school FAO thought that CAMs were ineffective because they were too junior and not knowledgeable about financial aid. This person believes that schools would benefit more by dealing with other FAOs or with ED staff in Washington, DC, instead.

Table II-5

Direct Loan Satisfaction with ED Regional Office Contact

Type of Contact	Timeliness (%)	Usefulness (%)
Training Received at the Regional Office	74.9	81.0
Training/Guidance Delivered by Account Managers at your Institution	64.2	67.4
Questions Regarding Direct Loan Policy	74.3	79.2
Entrance/Exit Counseling Issues	72.8	79.2
Requests for ED-Provided Materials	78.6	86.1
Questions/Issues Regarding Computer Systems Design or Implementation	63.2	63.8
Questions/Issues Regarding Loan Origination	70.8	70.4
Questions/Issues Regarding Disbursement and/or Refunding of Excess Funds to Borrowers	69.8	73.0
Computer-Related Reconciliation Issues	55.1	55.7
Accounting-Related Reconciliation Issues	57.3	56.7
Inquiries Requesting Appropriate Source of Contact for Specific Questions	70.7	73.5

Case study schools were also asked what they thought the role of the CAM should be. About half of the respondents thought their role should be to oversee the whole process. Schools also used terms such as "facilitator," "troubleshooter," and "ombudsman." Three schools thought that CAMs should make more regular site visits to all schools.

When CAMs were first implemented, there were approximately 115 CAMs. Currently, that number is down to 64 CAMs.[18] As a result, despite the fact that the number of Direct Loan schools has remained relatively stable between 1995-96 and 1996-97, three of the five Regional Offices felt they were understaffed. One Regional Office Director feels that the optimum ratio is 25 schools per CAM. The three Regional Offices that indicated they were understaffed had a ratio greater than 36/1.[19] The following table is a summary of CAM activity for the first half of the 1996-1997 academic year:

[18] As of October 1997, there were 76 employees in the Direct Loan Account Management Group. This number includes Regional Leads and administrative personnel. The current number of CAMs is 64.

[19] In one case, the ratio that the Regional Office self-reported was substantially different from the ratio supplied by ED staff in Washington, DC, headquarters.

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Table II-6

Client Account Manager Activity Summary: August 1, 1996, Through December 31, 1996

Region Number	Number of CAMs per Region	CAM/DL School Ratio (excluding leads)	Number of Incoming Calls Received by CAMs	Number of Title IV Training Sessions Conducted
1	5	32/1	377	33
2	7	38/1	617	93
3	9	26/1	404	35
4	12	23/1	721	63
5	8	38/1	772	60
6	10	21/1	329	67
7	6	23/1	478	37
8	6	28/1	273	25
9	11	26/1	800	75
10	4	18/1	580	45
Totals				
	78	25/1	5,351	533

Source: Department of Education Direct Loan Client Account Managers Report (January 31, 1997).

Client Account Managers Assumed New Roles

CAMs indicated that their duties had changed from when they first began in spring 1995. The reasons given for this change in focus were understaffing, changes in priorities, and the evolving nature of the program. At the beginning, one CAM said that he did "whatever it took" to provide assistance for schools to be successful. Now, they have to "draw the line and pull back on certain things." CAMs described their current role as similar to that which schools mentioned—providing technical assistance, including both telephone assistance and site visits; training; and work on special projects. Technical assistance included the areas of software, reconciliation, policy, and loan origination. In addition, CAMs are more experienced now and are better able to assist schools with problems.

Most offices indicated that they had cut down on "introductory" telephone calls. One CAM said that he does not "call to say hello" anymore. Another CAM feels he could be more proactive if he had adequate staff—especially in the areas of program promotion, school recruitment, and training. While offices have cut down on some areas, they have branched out into other Title IV activities (thus serving the whole financial aid community and not just Direct Lending), especially in training. One CAM mentioned that general improvements in schools' ability to administer the Direct Loan Program have contributed to this change in focus.

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Since many non-Direct Loan schools attend CAM-conducted training, the CAMs have been receiving a significantly increased volume of telephone calls and questions from non-Direct Loan schools on non-DL issues. Conversely, technical assistance for schools that have been in the DL Program for more than a year has decreased as they have become more familiar with the Program and its software.

One ED official thinks that CAMs are especially helpful to EDExpress schools because they know the software better than anyone else and that this is their real strength. Numerous CAMs singled out the software problems and the issues with the new LOC as their primary activities. CAMs were frustrated by the number of EDExpress software releases, the quality of the software, and the timing of the releases (software versions often arrived too late for staff to train schools on it).

Communication Between the Client Account Managers and ED Headquarters Staff Has Improved

Based on the observations of case study FAOs, it seems that the CAM concept has addressed ED's stated goal of "serving as a resource for institutions to assist schools in resolving problems." Macro reported last year that there seemed to be 1) confusion among ED officials and CAMs, both as to the CAMs' specific role and as to their effectiveness, and 2) a lack of communication and coordination between Task Force members and Regional Office field staff.

According to an ED official, the function of the CAMs was not adequately defined by ED. The role of the CAMs was supposed to be one of customer service and of serving as "the eyes and ears of the Direct Loan Task Force and disseminating information to schools." This lack of clarity, coupled with the fact that each Regional Office maintains a great deal of autonomy has led to a lack of uniformity and a wide interpretation of the CAM's role. In addition, organizational conflicts existed between the original Task Force and the Regional Office staff.

Prior to the 1996-97 academic year, management of the CAMs was moved from the Direct Loan Task Force to the Policy, Training, and Analysis Service. This integration placed the CAMs in the same group as all other training and customer service functions. One official thinks that these actions have centralized the function of the management of the CAMs. This central leadership has led to a more standardized role for the CAMs.

Since this reorganization, Regional Office staff "feel better about the way things are going" between them and ED, but reported mixed levels of satisfaction with communications and coordination. Of the five Regional Offices visited, two expressed an overall positive opinion about this relationship, one expressed mixed opinions, and two still felt that there was a lack of coordination and communication.

On the positive side, Regional Office staff indicated that the Task Force and other ED staff were more supportive and responsive and that there was no more strife among the Regional Offices and the Task Force. There is increased outreach, including frequent visits to the regions by Task Force staff and increased communication and cooperation among the two groups. One Regional Office Director liked the fact that he was now able to use the Task

Force as a funnel for questions, problems, issues, and administrative duties. This fact served to raise morale of the CAMs. One ED staff person said that the Task Force had "eliminated virtual warfare between the CAMs and the Task Force. The relationship is now cooperative, and the customers benefit by it."

The two leading negative comments were that some Washington, DC, staff did not listen to Regional Office staff and that most ED staff did not know what the Regional Offices did. Another Regional Office CAM felt that the Task Force is too bureaucratic, out of date, and unpleasant to deal with. This perception can potentially have a negative effect on CAM staff—especially recent graduates who are hired under the Outstanding Scholars Program and who are new to Federal service.

Another consistent complaint from the CAMs is that they need to be more informed about changes that are taking place at ED, so that when schools have questions, CAMs are prepared to respond. The CAMs in one office said that they often learned new information "by chance." One CAM said that the Task Force had a "bad attitude," including telling staff to read the manuals to gather information. Another CAM noted that the Task Force members are the primary offenders, because they forward questions to institutions without telling the Regional Office Staff. Clearly, there is not yet a two-way street in sharing information. CAMs say that more direction and a more uniform vision from ED would provide more support for the Regional Offices.

Client Account Managers Request Additional Training

CAMs originally went through an extensive training process between March-May 1995 and January 1996 when the CAM program was launched. Since that time, there has been no formal process to train either new or continuing CAMs. Areas in which CAMs indicated that they would like additional training are those in which changes occur frequently—software, policy and regulatory issues, and technical areas. Because of rapid changes, CAMs feel that it is important to be aware of different interpretations and scenarios, to assure that they give accurate information to schools.[20]

Proposed Q & A Database Scrapped

Regional Office staff reported to Macro last year that they were in the process of developing a National Question and Answer (Q & A) Database that was networked by means of Lotus Notes software. The objective of this database was to combine all school-based questions and answers and appropriate responses into a single resource that could be used by all CAMs. This Q & A database could be an important tool for the CAMs for both internal use and for use in providing assistance to institutions. It would also aid in the standardization of Direct Loan processes and procedures. This database is no longer in development. No explanation was

[20] We were told that ED will be resuming the practice of having CAMs undergo "externships" at FAOs in order to gain firsthand knowledge and experience of financial aid operations and that the Account Management Group is currently developing a training orientation package.

given for the decision to drop this project. Instead, Regional Offices are using various other methods of compiling and documenting school-based data.

It was noted by Regional Office staff that, while the intent of the Lotus Notes database was good, it was a "chore" to organize and update. ED staff at the Washington, DC, headquarters are instead using the weekly updates submitted by each Regional Office to update all Regional Offices on problems, issues, training, and staff involvement. They do this by compiling data from these weekly reports and distributing paper updates to the Regions. One Regional Office staff member believes that this information is of limited use because it does not contain information from the LOC, software contractor, and ED policy division.

Some Regional Offices are logging all correspondence by means of Microsoft Access software. Regional Offices using this method find it helpful for pulling up records of school correspondence. One reported drawback of this system is that it cannot be organized by function. Electronic mail was also mentioned as another tool that is being used for data gathering and sharing.

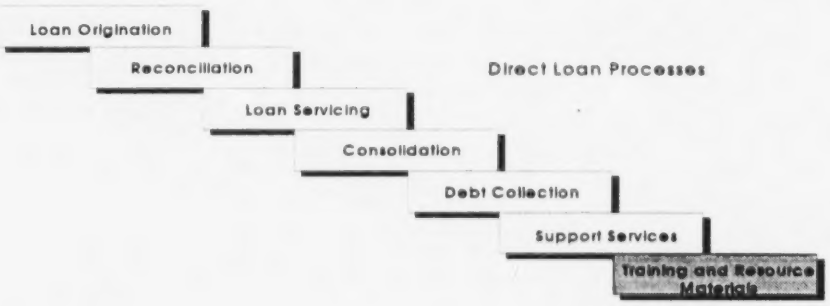
There is transfer of information between the Regional Offices and the Task Force in the form of weekly activity reports. Prior to the LOC conversion, Regional Offices received reports that listed triggers, such as school cash balance and current reconciliation activity. On the basis of these reports, CAMs were able to work with the ART in Washington, DC, to provide outreach to schools that were not successfully completing the reconciliation process (see the Reconciliation section for more information).

Recommendations

Recommendations in the support services area

- Provide more onsite technical assistance to schools. Use schools' "live" loan screens and data to train FAO staff and resolve problems.
- Provide more hands-on training to CAMs in the form of internships and training conducted by FAOs.
- Ensure adequate ongoing communication between ED staff and the Regional Office CAMs, so that everyone will be current on ED's policies and able to answer institutions' questions. This communication should consist of standardized reports/updates sent to each Regional Office on a timely basis.
- Increase the number of CAMs. The total number of CAMs has decreased dramatically since their inception. Increase the FT ceiling for the Account Management Group and ensure that the level of service to schools (and specifically, Direct Loan schools) remains high.

Training and Resource Materials



The Department of Education and its contractors provide a range of support services that are designed to provide training, materials, software, and technical references to Direct Loan institutions. This is in addition to providing customer service and technical assistance, which was described in the previous section of this report. ED continued to modify many of these services prior to and during academic year 1996-97.

Schools Were Generally Satisfied With Department of Education-Provided Services and Materials

During the 1996-97 academic year, Direct Loan schools were asked to rate the timeliness and usefulness of fourteen types of materials and training provided by the Department of Education. As described in the 1996-97 institutional survey, Direct Loan schools felt that the materials were useful, but were generally less satisfied with the Department's timeliness in providing the materials. For example, the ratings for usefulness ranged from 51 to 90 percent, while the ratings for timeliness ranged from 41 to 83 percent. The most useful materials and training were the pre-printed promissory notes (90%), borrower counseling materials (86%), and information on Direct Loan rules and regulations (80%), while least useful were the video conferences (51%), loan reconciliation support (52%), and software (56%). The most timely materials and training provided were the pre-printed promissory notes (83%), information on Direct Loan rules and regulations (73%), and the entrance and exit counseling videos (72%), while the least timely were the loan reconciliation support (41%), video conferences (52%), and training and technical support (54%).

When the responses from the Direct Loan and FFEL schools were compared for the Department of Education provided materials and training common to both programs, Direct Loan schools were significantly more likely in all cases to rate the materials and training received as both useful and timely. Direct Loan schools felt that the information on program rules and regulations, telephone support for policy or administrative guidance, borrower counseling materials, and software were more useful and timely than did the FFEL schools.

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However, when both Direct Loan and FFEL schools were asked about their satisfaction with the communications with their servicer concerning loan repayment and consolidation, FFEL schools were significantly more satisfied than Direct Loan schools. Seventy-four percent of Direct Loan schools expressed satisfaction regarding loan repayment communications, compared to 85 percent of FFEL schools. Regarding both in-school and out-of-school consolidation, 65 percent of Direct Loan schools were satisfied with communications from their servicer, compared to between 74 and 75 percent of FFEL schools.

Finally, when Direct Loan schools were asked to rate the timeliness and usefulness of their contact with the Department of Education's Regional Offices, the schools again felt that the material was slightly more useful than timely, with ratings for usefulness ranging from 56-86 percent, and ratings for timeliness ranging from 55-79 percent. The most useful type of contact were requests for ED-provided material (86%), entrance and exit counseling issues (81%), and training received at the Regional Office (81%), while least useful were computer-related reconciliation issues (56%), accounting-related reconciliation issues (57%), and questions and issues regarding computer system design or implementation (64%).

Table II-7

ED-Provided Materials/Training	Timeliness (%)	Usefulness (%)
Information on Direct Loan Rules and Regulations	72.9	79.8
Telephone Support for Policy and Administrative Guidance	56.8	68.7
Direct Loan Users Guide	63.2	67.1
In-Person Assistance	57.5	65.8
Borrower Counseling Materials	69.1	85.8
Training Materials for Counselors	66.3	74.6
Entrance/Exit Counseling Videos	71.9	72.9
Preprinting Promissory Notes	83.1	89.6
Reconciliation Guide	57.4	59.2
Consolidation Booklet	61.2	69.3
Loan Origination Support	57.0	64.6
Loan Reconciliation Support	41.0	51.8
Training and Technical Support	53.8	61.7
Software for Administration or Reporting Functions	53.9	55.9
Videoconferences	51.7	51.4

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Problems With EDExpress Software

The most frequent complaint among case study schools was that five versions of EDExpress software were released throughout the 1996-97 year.

Case study schools were asked to suggest improvements to EDExpress. Many felt that EDExpress could be improved by making it more user friendly, providing more online help so that users would not have to search through the manuals to solve a problem, and increasing the processing speed. One respondent in particular commented that the expected change in design of the 1997-98 version of the software (from a function-based system to a student-based one, allowing the user to shift between functions for a particular student) would be a significant improvement.

The 1995-96 EDExpress software included the following improvements over the 1994-95 version:

- The introduction of a Windows-based product;
- A simplified menu structure;
- A screen-save override so users do not have to save each screen when saving data; and
- Internal edits that prevent a loan record from being transmitted to the loan servicer if it is missing any required data elements.

Regional Office staff also indicated that software glitches and frequent updates were one of the major frustrations of Direct Lending schools. An ED official indicated that the problems with the development of EDExpress software stemmed from the failure to cut off submission dates for software requirements on a timely basis. As one ED official noted, "the Department must strictly adhere to cut off dates for software requirements definition, unless there are true 'show stoppers,' and hold software developers' feet to the fire to meet established deliverable dates."

Compared to prior years, ED made the 1997-98 software available much earlier—March 1997. ED has closed the requirements for 1998-99 software already and hopes to release it by early December 1997, assuming they can meet the 6-month development timeframe. If there are no problems with the 1997-98 software, this will be a significant improvement. One ED official is not convinced that most schools want this information earlier and would prefer to receive less frequent software versions and updates. The one exception is mainframe schools, because they need the lead time for programming. (ED does not provide mainframe software to institutions.)

The Department is planning on putting out a product for use with the more technically sophisticated Windows NT for 1998-99. However, one ED staff member does not think that ED or its contractors have the expertise to support multiple versions of EDExpress and remains skeptical about the release of this product.

Technical References Lack Detail and Clarity

Some FAOs at case study schools reported that the technical manuals and the *Software User's Guide* were useful resources but limited in scope. Topics such as loan changes and explanations of the loan origination error codes either are not covered at all or lack sufficient detail or clarity. Of the four case study schools that indicated that they used the *Software User's Guide*, only one school indicated that it was "very useful." The most frequently mentioned problem was that required steps were missing from the guide. One FAO said that "entire topics" were missing. Two schools felt that the guide was too technical. One school thought the format was not user-friendly.

An ED official concurred with schools' opinions of the ED-produced technical references. This official states that this material includes file layouts, edits, and other technical material but needs more narrative and explanations. The Department does produce nontechnical highlights of changes, but this official does not think that that is enough. ED will attempt to make this material more user-friendly beginning in the 1997-98 year. To that end, the LOC is preparing a new product for 1998-99 reconciliation updates to the software, which will include more narrative and clearer language. A new document produced for institutions, entitled the *Cash Management and Data Matching Guide*, was well received by schools and was deemed helpful in the reconciliation process.

ED Brings Training to Regional Offices

With the onset of permanent training facilities housed at the regional offices, ED greatly transformed its approach regarding training. In general, case study schools found ED-sponsored training to be useful and cost effective. Case study institutions cited the availability of training and expansion of training offerings at Regional Offices as enhancements over previous years.

All of the case study schools attended Direct Loan training sessions. Direct Loan-specific training sessions included training for new Direct Loan schools, cash management data matching (reconciliation), and EDExpress. Nonspecific Direct Loan training sessions offered include Title IV Update, consolidation, Student Status Confirmation Reports (SSCR)/National Student Loan Data System (NSLDS), bulletin board system (BBS), Pell Grant payment, application processing, packaging, Title IV WAN, and high school counselor training. Most case study schools reported attending at least one of these Title IV-wide sessions in addition to attending Direct Lending training. At a minimum, attendance at Direct Lending training included the FAO Director and Assistant/Associate Director for each case study school. Most case study schools sent many additional FAO staff members, including counselors, clerical staff, and loan coordinators.

Schools found many aspects of ED's training to be positive, including the small size of the training sessions, the "hands-on" approach to training, and the ability to interact with other schools. Schools used Direct Loan and other training to learn general concepts as well as specific implementation processes and procedures.

While most case study schools found the training beneficial, they indicated that the information on the training was slow to arrive at their school and sometimes arrived too late for them to attend.[21] The majority of schools felt that training was cost effective. Case study schools appreciated having the Regional Office training facilities available to them for training. In most cases, it allowed FAOs to attend training close to their institutions, thereby saving time and money. Of schools that did not find it cost effective, two indicated that they were shut out of sessions held in their region and had to travel to other regions; one school is not close to any Regional Office; and one school is located in a region that had delayed the opening of the training facility.[22]

Schools' Level of Experience Dictate Their Training Needs

Case study institutions seemed to have had different experiences with the training, depending on school type and the level of knowledge and sophistication they had going into the Direct Loan program. One large mainframe school said that FAO staff did not absorb any of the hands-on training and did not begin to understand what they needed to do until they actually implemented the program. The reason for this was that the trainers just read the material. FAOs thought that trainers should use a case study approach to training because real issues are discussed. Another large mainframe school said that Direct Loan training was geared to "brand-new" Direct Loan schools and therefore was not relevant to that school's staff. This school had spent an extended period of time planning for the program and found that the training was timed in such a way that schools are already performing the functions that the training addressed. Staff from a school that uses a custom software product to administer Direct Lending said that training was good for concepts and "planting seeds" to obtain information, but noted that they did not receive any details that were useful for their specific operating configuration.

Of the five proprietary schools visited, only one expressed an unqualified positive opinion of the training. Two schools felt that the training went too fast and was geared exclusively toward 4-year, Level 1 institutions. One proprietary-school FAO indicated that she was in training with people "who had never used a mouse before" and felt that it was hard to get to substantive issues when a lot of the training time had to be devoted to the basics. The fifth proprietary school said that the trainers "just read from the books."

Half of the case study schools viewed ED's video teleconferences. Generally, schools found them to be useful for general information but limited in scope and not to be used as a substitute for in-person training. Schools appreciated the fact that viewing the videotapes is an inexpensive and time-efficient way to provide training to a large number of staff.

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[21] ED staff noted that training announcements are posted in advance on an electronic bulletin board.

[22] All Regional Office training facilities were open when the site visits were conducted, except for one, which will open in winter 1998.

Client Account Manager's Training Activities

The consensus among ED staff is that internal ED-provided training has improved. One staff member notes that "we have added more sessions and we have reached more schools, adding depth and breadth of training." ED added new training offerings, such as application processing training, and separated training for new and experienced users.

As reported earlier, there was a significant shift in the focus of CAMs' duties. Training took up a much greater percentage of CAMs' duties in 1996-97 than in the previous year. In the preliminary planning by the Regional Offices, it was estimated that training would take about 15 percent of CAM staff time. In reality, this figure has been closer to 30 percent, according to data received from an ED official. This was due to the opening of the Regional Office training facilities as well as expanded training offerings by ED. In addition to the time commitment, many CAMs evolved from Direct Loan CAM into full-time trainers.

CAMs indicated that much of this time increase is due to the nature of training and the tasks involved. They indicated that they had to learn the training material, register FAOs, and set up training. One CAM thought that some of these administrative duties were not an optimal use of their time, but because of a lack of administrative support, there was no one else to do them. Ultimately the Regional Offices hope to piggyback on the automated telephone registration system being developed for the policy area.

Additional problems with training include the lack of CAM training on the material. One CAM felt like she was "roped into training without getting trained." Another frustration was the lack of timeliness in receiving this material and the quality of the training material. Staff at one Regional Office indicated that they have to rewrite substantial portions of the training material.

Regional Office staff indicated that the software contractor used to do software training but no longer does. This has increased the burden of the CAMs. The CAMs believe that the software contractor is better qualified to do this training.

Table II-8 highlights changes and additions for 1995-96 and 1996-97.

Table II-8 1995-96 Training Highlights
• Instead of one standard training session for all participants, separate training sessions for standard and technical users were conducted. A 1-day training session on EDExpress was also conducted for new users of the EDExpress software.
• Training sessions began soon after schools were admitted to the program, to allow for adequate preparation.
• Training sessions were extended later in the year, to allow for refresher courses and to train new staff.
• Training participants were given more "hands-on" computer experience during the training sessions.
• Training was conducted at Regional Office Training Centers; initial training was conducted at five sites across the country.
• Specific Reconciliation and Cash Management Training.
1996-97 Training Highlights
• Session was held for third-party servicers and commercial software vendors.
• Regional Offices have the discretion to add additional sessions as warranted.
• Application processing training was added. It will be relevant to all schools, not just those involved in Direct Lending.
• Reconciliation Training was further refined.

Recommendations

The following recommendations address training and resource materials:

- Create a policy and procedures manual for FAOs in user-friendly, ready-reference format.
- Further differentiate training into different sessions by school type and level of experience. Provide unique training for clock-hour and term-based schools.
- Improve EDExpress software. Modifications suggested by case study schools include providing online help and increasing processing speed of software.
- Improve the quality of the entrance and exit interview videotapes.
- Train the trainers on a timely basis, well before actual training is scheduled to occur.
- Provide more administrative support to CAMs so they can concentrate on communicating with schools and training activities.

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Chapter III

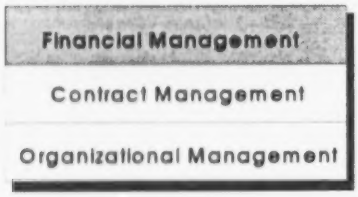
ED Management

Overview

This chapter describes three functional areas at the Department of Education (ED) that are critical to program management: financial management, contract management, and organizational management. These three areas are responsible for oversight of all processes and services described in Chapter II. Whereas Chapter II described the customer perspective for each process, the three sections in this chapter focus on the internal procedures and controls in place at the Department of Education. In conducting analysis, Macro focused on current activities, organization changes and improvement efforts, and the readiness of ED to handle current Direct Loan functional area and the increased number of outside contractors involved with the program. The following exhibit describes the three areas of ED management discussed in this chapter.

Management	Participants	Functional Description
Financial Management	ED Personnel, Independent Auditors	Management of the financing and investing activities of a program. This includes the management of internal controls, and accounting and transaction, and reporting activities.
Contract Management	ED Personnel	Management and coordination of all activities involved with the contracting process.
Organization Management	ED Personnel	Management of the overall program structure, including program coordination and communication. In addition it is concerned with staffing and performance measurement functions of the organization.

Financial Management



The design and use of financial management is important to the overall management of a program. Effective financial management ensures that basic requirements are met to provide complete, reliable, consistent, and timely financial information. The degree to which ED has provided financial management, as well as program management, for the Direct Loan Program affects how tax dollars are spent, how Federal assets are protected, and how efficiently student loan services are provided to the public.

Cash management involves the administration, oversight, and reporting of the activities related to the drawdown of Treasury funds to cover the issuance of Direct Loans. The process used to draw down the funds differs among the Option 1, Option 2, and Option 3 Direct Loan schools.

- Option 1 Schools (formerly Level 2 schools). The Loan Origination Center (LOC) generates a drawdown request for a particular school based upon information in that school's current loan origination records file. Relying on specific borrower records, the LOC determines the amount of funds that need to be drawn down to fund currently unfunded disbursements for that school and then the funds are electronically sent to the school. The funds must be used to cover the loans of the students indicated in the specific borrower records. If all or part of the funds are no longer needed for a particular student originally included in the records (i.e., the student drops out of the school), the funds must be returned to the Treasury immediately. They cannot be used for a student not included in the loan origination records.

- Option 2 Schools (formerly Level 1 schools). Funds can be drawn down by Option 2 schools at any time. The amount of funds the school is allowed to draw down is based upon the amount of funds the school can use to cover loan disbursements in a 3-day period. Funds are not designated for a particular student, as they are for Option 1 schools. For example, if a school draws down enough funds to cover the loan disbursements for 100 students and only 95 show up for the semester, the school does not have to return the funds drawn for the missing 5 students if the school can use the funds to cover the disbursements of any additional students requiring the funds during the next 3 to 10 days.

- Standard Origination Schools (formerly Level 3 schools). All standard origination schools use a third-party servicer or the LOC to perform all origination functions for that school. To make a drawdown request, the exact amounts that must be drawn down to meet disbursement requirements. The funds must be used to cover the loans of the students indicated in the

specific borrower records. If all or part of the funds is no longer needed for a particular student originally included in the records, the funds must be returned immediately to the Treasury. The funds cannot be used for a student not included in loan origination records.

Because of the 3-day timeframe, some large-volume Option 2 schools carry a consistent cash balance. In some cases, if a school has large cash reserves and the required systems, the school can choose to disburse the student loan funds from its own reserves before it receives the drawdown funds from the Treasury. From a cash perspective, this alleviates the need for a school to carry a cash balance. This arrangement is ideal from ED's perspective.

Cash management is important to the financial management of the Direct Loan program because drawdowns and disbursements create transactions that need to be properly recorded in ED records. When schools are not timely in distributing and reporting disbursements, the Department does not know the status of the cash disbursed from the Treasury or the amount of Direct Loans disbursed. This affects the Department's ability to accurately record the Direct Loans Receivable Balance, which causes financial reporting problems, and affects the Direct Loan Program's ability to service its loans.

During the past year, the Department has taken a number of steps to improve the management of its cash and to reduce the cash balances maintained at the schools. These improvements are discussed below.

The following discussion provides insight into Direct Loan financial management issues of importance in Year 4.

Increased Monitoring and Reporting Efforts Focus on Enforcement

The original statutes creating the Direct Loan Program included a requirement that all Direct Loan Schools must submit all loan origination records for reconciliation within 30 days. It is referred to as the "30-Day Rule."[1] For the first few years of the program, this rule had not been enforced by the Department, due to various program and systems development problems that occurred with the startup of the Direct Loan Program. In the past, the OIG's office had stated that the Department was creating a large liability because it was not enforcing the 30-Day Rule.

In response to growing concerns over school reconciliation, over the past year the Department began using the 30-Day Rule as a benchmark and intervening at schools that are not meeting this rule.

[1] The 30-day reporting requirement went into effect on July 7, 1996, and applies to all electronic records and paper promissory notes.

Reports Were Implemented To Aid Cash Management Efforts

In November and December 1996, "30-Day Reports" were implemented by the former LOC to monitor compliance with the 30-day regulations. These reports showed the status of loan records for the current reconciliation period. If a school had a high cash balance, usually it was because 1) the school drew down too much money or 2) the school did not comply with 30-day rule. One ED official stated that once the new LOC began originating loans, however, these reports were no longer produced. Another ED official stated that the new LOC recently began producing these reports.

In addition to the 30-Day Reports, in 1996-97, the Department provided the schools the ability to request a "732 Report" that shows all loan activity that the LOC had for that school. This provides the school an extra tool with which to monitor its own activities and be pro-active in solving its cash management problems.

Accountability and Reconciliation Team Integrates Into Financial Management of Student Financial Aid Programs (SFA)

As noted in earlier sections, to help address the large excess cash balances and 30-Day Rule compliance at Direct Loan Schools, the Accountability and Reconciliation Team (ART) was formed by the Direct Loan Task Force in the late spring of FY 1996. Initially the ART's function fell under the domain of the Direct Loan Task Force. In an effort to integrate the function into Office of Postsecondary Education (OPE), ART was turned over to OPE's Accounting and Financial Management Service (AFMS). AFMS was chosen because functionally this was the most logical area for ART to be placed in. The successful ongoing reintegration of ART and the work accomplished by ART is viewed as a major accomplishment by ED staff.[2]

Despite Its Efforts, ED Cash Management Still Experiences Problems

Despite the efforts of ART and the development of the 30-Day and 732 Reports, many ED officials remain cautionary, because

- Reconciliations are still not performed on a timely basis
- Option 2 Schools can still draw down funds without having the required origination records submitted to the Department.

[2] This reintegration occurred in August 1997.

If these problems are not addressed, reconciliation problems may have a greater impact on cash management in the coming years, because of the increase in the number of Direct Loans. For an in-depth discussion on reconciliation, please see the section of this report titled "Reconciliation."

The FY 1996 Financial Statement Audit Addressed the Direct Loan Program

As stated in previous year's reports, in Year 1, 1994-1995, of the Direct Loan Program an unqualified opinion for the Direct Loan Program financial statements was rendered. In FY 1994, the Direct Loan Program had only been in operation for 3 months of the fiscal year. The auditor's report, however, disclosed conditions in the program's internal control structure, in the loan origination, servicing, and reporting systems, that it considered material weaknesses. Owing to these conditions, the auditors made recommendations for improving the following areas of the Direct Loan Program, thereby enhancing the Department's ability to manage the growing program.

- Reconciliation and Reporting Processes—The report noted that improvements need to be made in the process used by the Department to ensure that loan origination data are accurate, are reported promptly, and are received by the Department.

- Cash Management Monitoring Ability—The report noted that the Department's ability to monitor school cash management practices needs improvement, and it recommended that the program reconcile specific advances for each month with specific loans disbursed for that month.

- Controls at the School Level—The report noted that the Department must improve its ability to promptly identify and resolve school level problems, including ensuring that complete and accurate supporting documentation is maintained in the student files and problems with system software and hardware are resolved.

In Year 2 of the program, 1995-1996, no individual audit was performed specifically for any individual ED program, including the Direct Loan Program. Instead, all programs were combined into the audit of the Departmentwide financial statements of the Department of Education. The auditors did not express an opinion on the Departmentwide financial statements.[3]

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[3] Obtaining an unqualified or clean audit opinion on the financial statements is a threshold event, indicating a baseline of fiscal maturity. The unqualified opinion is what organizations strive to achieve. An unqualified opinion means that auditors believe that the financial statements fairly present the operations and financial position of the reporting entity. Because Federal financial systems and internal procedures were not originally designed to produce financial accounting information, gaining an unqualified opinion can take years.

(continued...)

Although none of the material weaknesses cited by the auditors in their Fiscal Year 1995 report were attributed directly to the Direct Loan Program, the Direct Loan Program is indirectly affected. The auditors noted the following as a material weakness:

> The lack of complete loan data in the FFEL Program constrains credit management and the Department's ability to estimate a liability for loan guarantees.

The questionable reliability of the data used to calculate the liability estimate for loan guarantees of the FFEL Program affects the Direct Loan Program because the same data were used to calculate the Direct Loan Subsidy and Allowance for Loss on Credit Program Receivables. The Direct Loan Subsidy and Allowance was not mentioned as a material weakness because in FY 1995, the Direct Loan Program was still relatively small in relation to the other programs, specifically FFEL.

The audit performed for FY 1996 was a Departmentwide audit in which the Direct Loan Program was included. Again, the auditors did not render an opinion on the FY 1996 financial statements—mainly because of the problems reported by the auditors in previous years. In FY 1996, however, due in part to the increased size of the program, the auditors did include the Direct Loan Program in its reportable condition regarding "Oversight and Analysis of Audits of Postsecondary Education Institutions" in their *Report on Internal Controls*. Specifically for the Direct Loan Program, the auditors reported that the "guidance for on-site program reviews by Education personnel should more fully address Direct Loan issues." The audit report stated:

> In September 1996, Education issued an addendum to its Program Review Guide, which is used by Education personnel, to address issues related to the Direct Loan Program. This guide does not include procedures that would provide assurance about whether disbursement information the schools reported to Education are supported by the schools' books and records.

The guide does not require the reviewer to determine whether disbursement amounts and dates kept at the schools are consistent with the information maintained in ED records. It only requires reviewers to compare disbursement amounts and dates from the schools' loan origination records to the information the school maintains in the student records. Therefore, the auditors concluded that the guide does not provide procedures to validate the accuracy of the Department's records of Direct Loan receivables and recommended that the Department revise the *Program Review Guide* to require testing to directly validate Direct Loan

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[3](...continued)
The Department has received "disclaimers," which is the most common opinion issued by auditors on initial financial statements prepared by Federal entities. Disclaimers are issued when the auditors feel that they cannot express an opinion on the statements for various reasons, most commonly because of poor data quality, lack of data, or unreliable financial systems. Often, disclaimers result from problems which require long-term solutions.

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disbursement information maintained in the Department's records. In addition, the auditors recommended that the Department establish a process by which independent auditors of Direct Loan institutions could confirm with the Department, or with its Direct Loan servicing contractors, disbursement information maintained in the institution's records and require auditors to perform confirmations of Direct Loan disbursements.

Cost Data Are Not Available

There is an increasing need within the Department to accumulate, calculate, report, and monitor the costs of the various activities related to the student loan program. Such information provides student loan program managers with the information necessary to manage and control the costs of the programs. Currently, a few ED officials expressed concern over the lack of comparative measurement of unit costs of the Direct Loan and FFEL Programs for loan originations, servicing, and collections. One official also expressed concern over the lack of costing information with which to monitor the program, further stating that budgeting information was not adequate for this purpose.

OPE is currently exploring the possibility of using cost accounting methods to improve financial management of its processes and activities. Under a cost accounting program management will have the information to perform special analyses, such as determining the cost of implementing a new system.

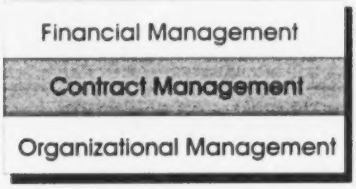
The following recommendations address financial management:

- Ensure that 30-Day Reports are implemented at the new LOC and provided to ED on a consistent basis.

- Continue ART efforts to address cash management problems at the institutions and actively enforce 30-day reporting requirement.

- As recommended by ED auditors, revise the *Program Review Guide* to require testing that directly validates Direct Loan disbursement information maintained in the Department's records and establish a process through which independent auditors of Direct Loan institutions can confirm with the Department, or its Direct Loan servicing contractors, disbursement information maintained in the institutions' records.

Contract Management



The following discussion discusses ED's Contract Management issues of importance in 1996-97. A number of issues related to contracting were cited during interviews and focus groups with ED officials in relation to the Direct Loan Program. These are issues that were not solely related to a particular contract or contractor, but that were mentioned as transcending the process areas and appearing more appropriately as a management area. Also discussed are a few contracts and/or contract-related areas that are not direct processes supported by Direct Loan but that have or will have interfaces that will consequently affect the Direct Loan Program.

An Overview of the Contracting Process

Typically, the contracting process at the Department begins when a program office has identified a need to obtain contractor services. During this preaward process, the program office determines its vision for the contract and begins an analysis to determine its requirements and alternatives for contractor support. To make the statement of work as focused and comprehensive as possible, it is critical that the program office use the preaward process to arrive at an agreed upon and comprehensive list of requirements, alternatives, and a vision for the project so that the statement of work will be focused and comprehensive.

After the program office has completed the requirements analysis and has defined its vision, the contract office is notified and a series of meetings between the program office and contracting staff is conducted to further discuss the contract requirements and alternatives and to examine legislative requirements that may affect the contract. Then, through a collaborative effort, a draft statement of work is written and distributed to various ED personnel for comments. Often, drafts are also provided to industry representatives to solicit their comments. As deemed necessary, changes are made to the statement of work (SOW) to include comments from ED personnel and industry representatives, and then a final statement of work and Request for Proposal (RFP) is developed and distributed to the public.

Interested contracting entities may then request a copy of the RFP. Depending on the requirements of the RFP, a contractor then makes a decision as to whether it wants to submit a response, including its plans for providing the services as described in the SOW and the related fees that the contractor intends to charge the Department for those services.

The Department Formulated a Contracting Vision for Direct Lending

According to an ED official, when the Department formulated its original vision for the Direct Loan Program in the preaward process, the Department defined the number and the roles of the servicing contractors, the system requirements, and other variables affecting servicing operations. Initially, the program office envisioned a larger number of contractors for servicing. It was deemed important and cost effective to let the contractors use their own proven systems and technology to deliver the services. In addition, the Department envisioned developing a competitive environment among the different contractors where they would compete for loans by developing their own cost savings measures, and the best performers would get more loans to service.

As noted by the ED official, that vision did not require a lot of systems involvement on the part of the Department. The systems already existed and were being used by servicers in other areas of the loan servicing market under the FFEL Program. It would, however, require that the servicers develop the ability to exchange data between the various systems.

The Vision Changed

After the implementation process of the Direct Loan Program began, an ED official stated that some officials within the Department began to question the vision and requirements of the Direct Loan Program. Some ED personnel believed it would be confusing to borrowers if the different contractors treated borrowers differently, and, therefore, some ED officials thought that the Department should specify systems standards across all Direct Loan servicers. That would require servicers to develop new systems based on strict Departmental requirements. As one ED official noted, this approach was drastically different from the Department's original vision. It diminished the opportunity for competition among the servicers and took away the Department's opportunity to take advantage of technological innovations within the industry. As one Department official noted, if all the servicers are required to provide the exact same systems and methods, there is little room for creativity or opportunities for cost savings that would allow servicers to offer more competitive rates.

According to the ED official, this altered vision created problems in defining requirements for the loan origination contractor and servicer contract. While some ED officials thought these contractors should be permitted to follow their own proposed approaches, other officials thought the Department should be in control and that the approaches should be clearly specified to the contractors. Department Assistant Secretary for Postsecondary Education David Longanecker stated that ED made these procedural changes because the contractors did not deliver within the performance-based structure. Longanecker also stated that this is a new process and therefore, problems are inevitable at the outset.[4]

[4]Student Aid News, November 7, 1997.

The New LOC Experienced Problems

The new Loan Origination Center was awarded to EDS in the last quarter of FY 1995 with the intention of beginning to originate and consolidate Direct Loans on January 20, 1996, 4 months into FY 1996. Due mainly to systems development related problems, the loan origination system did not actually begin in-school and regular consolidation until September 20, 1996 (10 days before the end of FY 1996) and did not originate Direct Loans until March 3, 1997, 6 months into FY 1997. A number of ED officials expressed concern over the new LOC's lack of ability to originate and consolidate Direct Loans, especially the huge volume of loan originations that are projected to occur in the Fall 1997 semester. This subject is described in more detail in the Loan Origination section of this report.

From a contracting perspective, some at the Department think that the lack of technical input and the lack of collaboration in defining contract requirements contributed to the problems experienced by the Department and the new LOC. For instance, after the contract was awarded, the Direct Loan staff began imposing requirements on the LOC that were not written in the contract's statement of work. From a contractual standpoint, the LOC could not perform those activities without a modification to the terms of the original contract. For example, the original CDSI contract required its technical representatives to travel to Direct Loan schools when the school experienced problems with its individual systems. When the new LOC contract was written, there was nothing included in the contract requiring the new LOC to perform this same service for the schools. When the new LOC was on board and the schools started to experience internal systems problems, EDS did not intend to perform this activity because the firm was not obligated to incur cost. This caused a customer service problem with the schools. If the Department had included this requirement in the original contract, EDS should have been prepared to offer these services and would have included such trips in its fee structure and work plan.

The New Servicers Were Obliged To Change Their Approaches

Although the Department decided to terminate the new servicing contracts, resources were expended due to a change in contracting approach. The new Direct Loan servicer contracts were awarded September of 1996 with the intention of beginning to service loans in July of 1997. As stated by an ED official, this date was originally delayed, in part because after the servicers were awarded contracts in September, ED issued a comprehensive set of business rules that new servicers were required to follow. These business rules were not incorporated into the original SOW and the additional requirements changed the way the contractors planned on providing their services to the Department. Therefore, the contracts with the servicers had to be modified. This incident has had the following effect on the Direct Loan Program:

- Additional Departmental and contractor resources were spent in modifying and renegotiating the contracts.

COTRs Are Not the Central Point of Contact

Each contract issued by the Department is assigned a Contract Specialist. It is the role of the Specialist to provide technical assistance and to be the central point of contact between the Department and the contractor. The contracting officer (CO) works with the Specialist to enforce contractual requirements and regulations, approve and track contractors' invoices, and ensure that the contractor is meeting terms of the contract. In order to productively work in conjunction with the Specialist, the CO is expected to become very familiar with each contract assigned to him or her, including visits to various contractor sites. In addition, efforts are made by managers at the contracting office to provide training by technical and financial aid personnel on the student loan processes.

Performance-Based Contracting Is Still on the Department's Agenda

The Department is still in the process of implementing mandatory performance based requirements and incentives in new contracts and contract renewals. ED adopted this approach in the last few years as an attempt to deal with the increase in loan volume while maintaining a high level of customer service. In addition, there was a concern that the initial servicing contract provided fees on a per-borrower basis, plus additional fees for delinquent accounts, thereby making it more profitable to the contractor for borrower accounts to become delinquent and to generate additional fees. Under performance-based contracting, servicers would receive fee incentives if they prevented borrowers from entering delinquency.

During implementation of the LOC and the new servicers, Departmental efforts have been focused on implementation issues while performance measurements and incentives are still in the planning stages. Department personnel indicated that after implementation issues have been addressed, ED intends to utilize performance measurement incentives under Direct Loan contracts.

One of the Largest Data Systems in the World Experienced Problems

The National Student Loan Data System (NSLDS) contains extensive data about Federal student aid recipients. The data are used by the Department for monitoring student eligibility, calculating loan default rates, and aiding in decision and policy making. NSLDS was implemented 2½ years ago and contains one billion records of information on 34 million recipients of student aid during the past 30 years. This information includes data on the following student loan programs: FFEL, Perkins, and Direct Loans. In addition, NSLDS contains information regarding all Pell Grants disbursed since 1993. Future plans for the data system include processing data for recipients of other Federal grants and work/study programs.

The quality of the data in NSLDS has been a major concern of both Departmental and non-Departmental officials. The data from NSLDS come primarily from guaranty agencies or FFEL servicers for the FFEL Program, and they in turn receive the data from banks and other lenders.[5] For the Direct Loan Program, those data comes from the servicer(s). Over the past 2 years, the Department has identified the following data problems within NSLDS:

- Direct Loan balances were doubled for many borrowers
- Cohort default rates had to be recalculated, owing to database problems
- Approximately 12 million loan records have not been included into the database because of data discrepancy

In addition to data problems, ED officials have raised concerns regarding the following NSLDS system problems:

- NSLDS is not user-friendly
- NSLDS needs to be reconciled with other systems
- NSLDS is not readily compatible with other Title IV systems and the Department has made limited progress in integrating it with those systems
- The electronic SSCR is not working, because schools are having problems communicating with NSLDS
- The servicer and NSLDS are having problems communicating
- Loan data do not come from the schools, reducing data quality
- NSLDS is expensive and inefficient.

The Department had made some progress in improving NSLDS data quality:

- From January 1995 through the first half of 1996, NSLDS identified more than 125,000 applicants as prior defaulters who were applying for additional aid. This helped prevent an estimated $310 million in future defaults and denied about $75 million in Pell Grants
- Since January 1997, the cumulative error rate for NSLDS on data submitted by guaranty agencies since January has dropped from about 15 percent to 4 percent.

[5] NSLDS also receives student status data from schools.

- The Department is currently testing the use of electronic data interchange standards to improve data quality and reduce system costs.

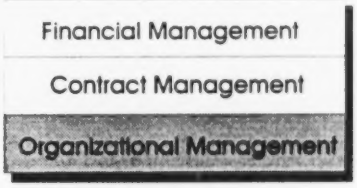
Contract Management Recommendations

1. Continue to include performance based incentives into new and renewed student loan contracts.

2. Improve the coordination process between the COTR and relevant ED stakeholders to ensure that guidance is provided to contractors through appropriate lines of communication and that ED's needs are being met (e.g., COTR and stakeholder team meetings).

3. ED needs to consider and coordinate the development of contract vehicles and SOWs at the earliest stages in the contracting process in order to provide clear guidance to contractors and to eliminate unnecessary effort by contractors to meet revised SOWs.

Organizational Management



This section examines organizational management of the Direct Loan Program, including an evaluation of ED's Direct Loan-related efforts in organizing its internal management structure, staffing, reporting, and communication and coordination between groups.

ED Activities/Perceptions

Organizational Management Experienced Successes

ED officials report a number of successes in the organizational management area this year:

- The Direct Loan account managers and Task Force have forged a more cooperative relationship, which benefits customers.
- The Direct Loan Interface meetings facilitate communication—these meetings include all stakeholders to the Direct Loan process (representatives from origination, servicing, Direct Loan systems, Task Force, NSLDS, DCS, EDExpress/CPS, AFMS, and CDS).
- Two consultants from the banking industry have been brought in to help bolster the Department's experts in the servicing area and to learn the servicers' systems.

OPE Organizational Structure Is in Question

Unofficially, about two thirds of the planned reintegration of the Direct Loan Staff into SFAP, planned for October 1, 1996, has been completed. As illustrated in Table III-1, several functions have been reintegrated. Many Direct Loan systems functions have been successfully integrated into PSS. The ART function has recently been moved to AFMS. Direct Loan training and publications schedules have moved to PTAS. Although the Direct Loan task force is still monitoring schools' level of participation, IPOS has successfully taken on other functions, according to one ED official. IPOS now reviews the application for school selection to the program, assigns the origination level, and reviews Direct Loan schools. IPOS has

mechanisms in place to monitor schools, but one ED official admits that they don't yet have a lot of experience in the Direct Loan program.

Although a preliminary reintregration plan was written and circulated, to date none of the reintegration has occurred officially. There has been no indication given as to when this official notice may occur. Rather, reintegration seems to be occurring at individual offices independent of any larger plan.

Table III-1

Task Force	*reintegration* →	Office of Postsecondary Education (OPE)
Direct Loan systems-related functions		Program Systems Service (PSS)
Accountability and Reconciliation Team		Accounting and Financial Management Service (AFMS)
Direct Loan training and publications (except distribution of publications)		Policy, Training, and Analysis Service (PTAS)
IPOS-related functions		Institutional Participation and Oversight Service (IPOS)

A Direct Loan Task Force with reduced functionality remains. The smaller Task Force will address outreach, customer support, and program management (such as new processes, systems, policy, and accounting). It is likely that the Direct Loan Task Force will remain an independent body, although a new Program Management Group has been formed to perform functions similar to those of the Direct Loan Task Force for all SFAP programs and will also address SFAP data reporting and MIS.

A number of original reintegration recommendations remain incomplete and, according to ED staff, may never be implemented, including

- Implementation of an SFA communications team
- Transfer of Direct Loan publication distribution to the PTAS contractor
- Reengineering of school program participation processes.

Additionally, a number of concerns about the organization of the Direct Loan program remain. ED officials raised the following issues:

- It is unclear what organization should provide program guidance and requirements for program consolidation in the long run.

- One ED representative suggested that Direct Loan become more customer oriented by aligning along product lines and integrating functions (e.g., those related to consolidation or Direct Loan) throughout the organization.

Organizational management continues to be a challenge for the Department—one that may be costly to the ultimate success of the program. One ED official suggested that the "instability and change in leadership, organization, and contracts [has, over the last year,] created uncertainty and drained energy and resources from operations."

Coordination Between Groups Remains a Challenge

There continues to be little improvement in the coordination and communication between the various Direct Loan groups within the Department, according to a number of internal sources. Some of the problems are

- Lack of clear role definition among functions, e.g., systems staff are making Direct Loan policy decisions—it is a fuzzy line between policy and systems.
- Lack of a cohesive agenda; instead, many little groups seem to have their own agendas (and may be working against one another instead of together, according to an ED official).
- Lack of full participation of OPE offices not solely involved in the Direct Loan program.
- A lack of communication and duplication of effort seems to be the result of the separation of the Direct Loan Task Force, the Direct Loan Account Management Group, and the part of the Policy staff that deals exclusively with Direct Loan policy.

Severe Staffing Shortages Exist in Key Areas

It is clear from statements by several ED officials that perceived staffing shortages exist in core organizational units. The Program Systems Service is critically understaffed. One ED official in the systems area said, "Staffing is a disaster; management refuses to listen—we simply don't have the horsepower." Another ED representative noted that systems is trying to support 1) the servicing contractor, 2) the origination contractor, 3) the Central Data System (CDS), and 4) FARS, with the same number of staff it had used to monitor one contractor with all the functionality. There is concern that shrinking resources will stifle the innovation and risk taking necessary for improvement. There is also some concern internally that the Department does not have the right people, with the right training, doing the right things:

- Because the systems group was under a hiring freeze/ceiling when servicing was kicked off, they brought in GS-7 Outstanding Scholars with no program knowledge or systems experience (although they desired GS-13's) to provide systems management.

- "We hire people who don't understand Federal procurement, and there are no attempts to train them afterwards . . . . people need to know what the contract proposes/requires—they must have an understanding of what the contractor can and cannot do under a particular contract."[6]

- The Department micromanages its contractors by requiring contractors to do things a certain way and not letting them bring their expertise to bear.

Several external stakeholders have also been concerned about the Department's staffing in certain organizational units. The IG has been critical of the Department's technical expertise, in both information systems managers and staff at the Department. Representative Hoekstra notes,

> *The Department is ill-equipped to run the FDSLP. The Education Department lacks the management personnel and experienced staff to operate the direct-lending program. It has experienced alarmingly high turnover among high-ranking employees in the Office of Postsecondary Education and has had "a shortage of qualified staff and managers in key technical areas and high number of temporary staffing actions," according to the inspector general's report.*[7]

ED has addressed staffing in the loan servicing area by hiring two new Task Force members who have extensive servicing experience in the FFEL Program. These new staff members will impart their knowledge to other ED staffers who have not had any servicing experience.

Performance Measurement and Reporting Lacking

The dissemination of Direct Loan Program information continues to be touted as one of the major benefits of housing a loan program at the Department level. The Assistant Secretary noted that in the Direct Loan Program, "electronic data would be available on how much money schools were drawing down to make loans and how much they were disbursing to students, allowing us to actually manage the program."[8] Yet, several ED officials remain

[6] ED official, Interview Notes, August 1997.

[7] Representative Hoekstra, Pete, *Focus on Direct Lending*, July 31, 1997.

[8] Longanecker, David, Statement on Student Financial Aid Delivery Systems before the Committee on Labor and Human Resources, United States Senate, May 15, 1997.

frustrated by the lack of information regarding cost and productivity, including baseline and benchmarking information.

Although one ED official noted that the performance measures have been developed at the Direct Loan program level in accordance with the Government Performance and Results Act, it was unclear how day-to-day performance of the Direct Loan program was measured (and how those measures tied to broader measures). Performance measurement and reporting continue to be a problem for the Direct Loan Program and it seems to be systemic—issues were noted in origination, reconciliation, servicing, and consolidation.

Recommendations

Recommendations in the organizational management area include the following:

- The Department must focus on reporting and performance measurement and ensure that all planned efforts to improve reporting are completed. ED needs to develop the ability to baseline and benchmark Direct Loan processes and outcomes.

- The Department must address critical staffing issues by ensuring, at the minimum, that key areas within the Direct Loan program have the necessary number of people and that key personnel have the right expertise.

- The Department must provide clear descriptions of duties for key Direct Loan personnel and guidance regarding the Student Financial Aid Programwide reorganization. This should include finalizing reintegration plans and activities.

- The Department must determine whether current Direct Loan personnel have the necessary and applicable skills needed to perform their duties at a high level of competence.